

DEPARTMENTS OF TRANSPORTATION, TREASURY AND GENERAL GOVERNMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 2004

TUESDAY, MAY 20, 2003

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:11 a.m., in room SD-138, Dirksen Senate Office Building, Hon. Richard C. Shelby (chairman) presiding.

Present: Senators Shelby, Specter, Murray, and Byrd.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF HON. JOHN SNOW, SECRETARY

ACCOMPANIED BY TERESA MULLET RESSEL, ACTING ASSISTANT SECRETARY, MANAGEMENT AND BUDGET

OPENING STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Good morning. The committee will come to order.

I would like to welcome John Snow, Secretary of the Department of the Treasury. Thank you, Mr. Secretary, for appearing before the subcommittee today to discuss the fiscal year 2004 budget request for the Department of the Treasury. I look forward to learning about the new leadership you bring to the Department as well as the resources necessary to carry out the responsibilities at the Department.

The Department of the Treasury has undergone significant changes since the transfer of the majority of its law enforcement bureaus and related functions to the newly created Department of Homeland Security and the Department of Justice. In the midst of those changes, the Department still maintains the key role in Government as economic policymaker, financial manager, and revenue collector. That is no small task, especially now as the country seeks economic recovery, job creation, and comprehensive tax reform and relief.

The Department has also created a new Bureau, the Alcohol and Tobacco Tax and Trade Bureau, and also anticipates consolidating the Office of Inspector General and the Inspector General for Tax

Administration. I am interested in learning, Mr. Secretary, more about those plans.

As the threat of terrorism continues, finding ways to combat money laundering and other terrorist financing tools is an important role for the Department. It is vital to our ongoing counterterrorism efforts that we know what resources the Department will need to combat such nefarious activities.

Treasury's budget request for fiscal year 2004 is \$11.408 billion, which includes \$21.9 million for the activities of the Office of Foreign Asset Control, \$57.5 million for the Financial Crimes Enforcement Network, and \$5.3 million to increase the counterterrorism activities of the Internal Revenue Service's (IRS) Criminal Investigations Unit.

These three bureaus within Treasury form part of the backbone of our ongoing fight against terrorist financing. Recent attacks in Saudi Arabia, Morocco, and Israel have shown it is important that we maintain a coordinated focus and provide the necessary resources to ensure that our combined efforts to disrupt terrorism financing are persistent and effective.

Turning an eye toward the more traditional functions of Government, I want to briefly touch on the \$10.4 billion request for the IRS that was discussed at length at a prior subcommittee hearing. The IRS' ongoing business system modernization efforts will require \$429 million in the year 2004. The subcommittee appreciates the efforts that continue to go into this massive upgrade that we hope will improve the speed, timeliness, and accuracy of IRS administration of the tax system.

I am aware, Mr. Secretary, that last year's efforts encountered a hiccup of sorts. However, I am interested in hearing how the Department is working with the IRS to get back on track and ensure that schedule and cost setbacks do not become common occurrences.

While the IRS' traditional role is to implement and enforce our tax laws, it has also been charged with administering the Earned Income Tax Credit. The budget proposes a number of changes to that program because of the high level of fraud associated with the program's administration. Each year, the IRS makes approximately—Mr. Secretary, listen to this number. Each year, the IRS makes approximately \$9 billion in erroneous Earned Income Tax Credit payments—\$9 billion. This is a direct and permanent loss to American taxpayers because it is virtually impossible to recapture these payments once they have been made.

To implement the EITC Task Force recommendations, the Department is requesting \$100 million to address the problems associated with the current program administration that results in overpayments. Eliminating erroneous payments and ensuring the proper administration of this program are certainly goals with which I completely agree.

In conclusion, Mr. Secretary, I believe this is a straightforward budget that includes a number of important reforms and efforts at modernization. I appreciate that it will take time for the Department to adjust to the realignment of offices to the Department of Homeland Security and the Department of Justice. Mr. Secretary,

I am confident that you have the opportunity to emerge stronger and more focused than ever.

I want to thank you for being here today, and I look forward to your testimony and the question period.

Senator Murray.

STATEMENT OF SENATOR PATTY MURRAY

Senator MURRAY. Thank you, Mr. Chairman.

I want to welcome Secretary Snow back to the subcommittee. Over the years, he has testified both in public and private capacities on a variety of transportation issues, and I have to say I am tempted to ask him about how we can enhance Amtrak's profitability or how we can improve management of our air traffic control but, rather, I will focus on Treasury issues this morning: the Earned Income Tax Credit, foreign sales corporations, and the Administration's plans in Iraq.

Let me start with EITC because I am concerned about the President's plan to spend \$100 million to target low-income families and possibly deny them this critical tax credit.

The EITC is designed to help the working poor. It is probably the most targeted means-tested tax benefit in the entire Federal code. It was started by President Ford, and it was greatly expanded under President Reagan. While many working families are eligible to receive it, as many as 25 percent or more of those eligible families do not even apply for it. We should be taking steps to allow more eligible families to get the help they need, but I think the President's proposal goes the other way. It has the potential to throw many honest eligible families off the rolls by putting a complex paperwork burden on families who are already struggling. It could also have a chilling effect on many families who may be intimidated upon receiving an official notice from the IRS questioning their eligibility.

We are told the goal is to minimize fraud, and I think we all agree that is an important and appropriate goal. Tax fraud by any taxpayer should never be tolerated. It is a disservice to every other family that works hard and plays by the rules. But I think there are many unanswered questions about whether the President's plan would meet that goal or whether it will end up purging many families who need it from the program.

I have asked questions about this on a number of occasions, and I haven't gotten clear answers, and so I hope Secretary Snow is prepared to answer questions in detail today.

On the most basic level, I would like to know if targeting the working poor is the most effective use of \$100 million or if there are other places where we can get more bang for the buck in reducing tax fraud. It is estimated that hundreds of billions of dollars in tax revenue never come in every year because of tax cheats and people who underreport their true income. Will the Treasury reap the greatest benefits by clamping down on the working poor or on multimillionaires and their tax attorneys who use questionable means to dodge taxes?

This subcommittee and our companion subcommittee in the House have not gotten straight answers. The IRS claims this is a balanced effort, balanced between fighting fraud and boosting par-

ticipation for eligible families. That sounds good. However, the vast majority of the \$100 million goes to increased enforcement, while only \$13 million goes to increased outreach. That doesn't sound very balanced to me.

I would also like to know if the Treasury Department through the IRS will have a formal public comment period before it publishes the pre-certification rules. Will the Administration evaluate the impact of its pilot project on working poor families before it expands this initiative to 2 million families nationwide? We have been told that the Administration plans to require the study, but we don't know if the Administration and the subcommittee will have the results in hand before the initiative is launched. I hope Secretary Snow will be able to answer those questions this morning.

Another issue that concerns me is the Administration's support for repealing the Extraterritorial Income (ETI) Exclusion Act of 2000 in response to a World Trade Organization dispute with the European Union. ETI, previously known as Foreign Sales Corporation, provides a tax break to U.S. exporters who employ American workers. ETI creates and sustains jobs for American workers. According to a recent study, exporters that benefit from the ETI may employ as many as 3.5 million American workers, including more than 100,000 in Washington State.

I am very concerned that the Administration has thrown up a white flag on this issue. The Administration's actions could give the Europeans a green light to threaten \$4 billion in retaliatory tariffs against American agricultural and manufacturing exports. If we proceed with the Administration's white-flag approach, we will give Europe a tremendous competitive advantage and will hurt American workers.

I have written to the U.S. Trade Representative about this, but I still have not received a response, and I hope the Secretary will have more to say about this important economic policy and tax issue.

Finally, I will ask several questions about U.S. efforts in Iraq. I am anxious to hear from the Secretary regarding international participation in the effort to rebuild Iraq. We have all seen the news reports that the effort to rebuild Iraq could cost up to \$600 billion over the next decade. The Administration's budget request is silent on these costs, and we have been told there will not be another supplemental funding request this year. I hope the Secretary can give the subcommittee and the full Appropriations Committee greater information about this issue.

I am curious about the Administration's latest thinking on international participation in the effort to rebuild Iraq. In particular, what role does the Administration see for the United Nations and countries that did not join the coalition forces in Iraq? Several Administration officials have given the Appropriations Committee very general responses to that question. I hope the Secretary will be more forthcoming with this subcommittee on the Administration's current position.

Finally, I will have questions for the Secretary regarding the Administration's views on contracts negotiated by Saddam Hussein's regime. I understand there are numerous high-profile examples of

Saddam's business dealings, some of which were agreed to with the specific objective of undermining international economic sanctions placed on the regime. I believe these contracts should be set aside. The new Iraqi Government should not be burdened with Saddam's business dealings. I hope the Administration agrees with me on this issue, and I hope we can work together to ensure that no U.S. taxpayer assistance is ever used to reward Saddam's business partners, those who actively worked to undermine economic sanctions on Saddam Hussein.

So, Mr. Secretary, again, I welcome you here today and I look forward to your testimony and a good dialogue this morning as we move forward to craft our bill for the coming fiscal year.

Thank you, Mr. Chairman.

Senator SHELBY. Senator Byrd.

Senator BYRD. Mr. Chairman, I thank you and I thank the ranking member for your comments. I will save my time for questions.

Thank you.

Senator SHELBY. Mr. Secretary, we welcome you to the committee. Your written statement will be made part of the record in its entirety. You may proceed as you wish.

STATEMENT OF SECRETARY JOHN SNOW

Secretary SNOW. Thank you very much, Mr. Chairman, Senator Murray, Senator Byrd. It is a great pleasure to be here today and to have this opportunity, with Acting Assistant Secretary Teresa Ressel, to be with you to discuss the Treasury Department's fiscal year 2004 budget request. I will make a brief oral statement and ask, Mr. Chairman, that my full formal statement be included in the record.

You hit on the fundamental issue we face in a management sense in your good opening comments, because it is clear that with the creation of the Department of Homeland Security, the Treasury Department has undergone the most significant transformation in its long history. And the recent divestiture of most of the Treasury's law enforcement bureaus has created an opportunity—I think a very important opportunity and one we want to make the most of—to refocus on our core mission. This core mission would in my view encompass the following things:

First, creating jobs for economic growth, security, promoting economic security, jobs, and growth. That broad category of things is something that the Treasury Department I think has to be terribly focused on.

Another broad category of things that the Department needs to be focused on is ensuring that the tax system is effectively administered and is fair for all taxpayers.

And, finally, the Treasury Department has a critically important mission in focusing on fighting the financial war against terrorism.

The budget proposal which we have submitted for fiscal year 2004 totals \$11.408 billion. We have provided the committee with a detailed breakdown and justification for this request. I would like to take the opportunity here this morning to highlight three areas of particular importance.

First, going to the primary mission, developing and implementing policies to provide economic security, jobs, and growth for

the American people. Of course, this mission is embodied in, among other things, the President's plan for Jobs and Growth, which is pending before both bodies of the Congress. The goals of the Jobs and Growth plan are to stimulate consumer spending, promote investment by individuals and businesses that will lead to economic growth and job creation, and deliver critical assistance to unemployed citizens. The fact is we are in a recovery, but it is too slow. As a result, too many Americans don't have work.

Second, Treasury is working to ensure that the U.S. tax system is fair for all Americans. That is a critically important part of what Treasury is all about. A cornerstone of Treasury's mission is helping citizens meet their tax responsibilities while maintaining the fairness of the system and respecting individual taxpayer rights, a matter that was touched on in the opening statements as well.

Of course, this mission is mainly the responsibility of the Internal Revenue Service (IRS), the biggest single part of the Treasury Department. IRS is responsible for collecting most of the revenues of the United States Government.

Thirdly, as is increasingly becoming apparent, I think, and as you mentioned, Mr. Chairman, in your opening comments, Treasury serves a critical role in fighting the financial war on terrorism. This work touches on several of Treasury's core functions and involves many of our jurisdictions, our offices, and our departments.

Treasury implements the financial war on terrorism through a number of mechanisms, including a new Executive Office of Terrorist Financing and Financial Crime, which will work with the International Affairs Terrorist Financing Task Force and with the office devoted to critical infrastructure protection in the Office of Domestic Finance. So this war on terrorist finance cuts through a number of different divisions of Treasury.

Finally, I would like to add that the Treasury Department continues to use the five elements of the President's Management Agenda as a guide to achieving our key priorities in accomplishing the Department's overall mission.

PREPARED STATEMENT

Let me say in closing here that I look forward to working with you, Mr. Chairman, with members of the committee, and your staff as we move in fiscal year 2004 to maximize Treasury's resources to see that we are doing the best job we can in the interests of the American people. I am hopeful that together we can work to make the Department a model of good management and good service to the American people.

And, with that, I thank you again for the opportunity to be here and look forward to trying to respond to your questions.

[The statement follows:]

PREPARED STATEMENT OF JOHN SNOW

Chairman Shelby, Ranking Member Murray, and members of the Committee, I appreciate the opportunity to discuss Treasury's fiscal year 2004 budget request.

With the creation of the Department of Homeland Security, Treasury has undergone the most significant transformation in its 214-year history. The recent divesti-

ture of a majority of Treasury's law enforcement bureaus and related functions¹ has provided an opportunity for Treasury to refocus its core missions. Treasury continues to fill a crucial role in economic policy making, international economic development, the financial war on terrorism, tax administration, banking and financial markets, and the government's financial management.

The budget proposal for fiscal year 2004 totals \$11.408 billion. I am committed to rooting out ineffective programs and will continue the challenge begun in the fiscal year 2003 budget process for each Treasury bureau to carefully examine their operations to improve efficiency and effectiveness.

We have provided the Committee with a detailed breakdown and justification for Treasury's fiscal year 2004 budget request. I would like to take the opportunity today to just highlight four areas of focus for fiscal year 2004:

- Providing economic security, jobs, and growth,
- Ensuring the tax system is fair for all through a comprehensive compliance effort,
- Serving a critical role in the financial war against terrorism, and
- Maintaining the integrity of our Nation's financial systems and safeguarding our Nation's currency.

PROVIDING ECONOMIC SECURITY, JOBS, AND GROWTH

Treasury's primary focus is on developing and implementing policies to provide economic security, jobs, and growth for the American people. This mission is embodied in the President's Plan for Jobs and Growth. Its goals are to encourage consumer spending that will continue to boost the economic recovery; promote investment by individuals and businesses that will lead to economic growth and job creation; and deliver critical help to unemployed citizens. The President's proposal would: speed up the 2001 tax reductions to increase the pace of the recovery and job creation; encourage job-creating investment in America's businesses by ending the double taxation of dividends and giving small businesses incentives to grow; and provide help for unemployed Americans, creating new re-employment accounts to help displaced workers get back on the job.

ENSURING THE TAX SYSTEM IS FAIR FOR ALL THROUGH A COMPREHENSIVE COMPLIANCE EFFORT

A cornerstone of Treasury's mission is helping our citizens meet their tax responsibilities, while maintaining the fairness of the tax system for all and respecting taxpayer rights. This is mainly the responsibility of the Internal Revenue Service, which collects most of the revenue needed to operate government. This responsibility entails:

- Meeting the annual demands related to processing over 2.6 billion tax-related documents,
- Sending out over 95 million tax refunds,
- Providing quality service on taxpayer phone calls, email and walk-in assistance concerning tax law and account-specific questions, and
- Maintaining a balanced and comprehensive enforcement presence.

The fiscal year 2004 budget provides \$133 million of new funding to focus resources and staffing toward the most significant areas of non-compliance, resulting in more examinations of high-income taxpayers and businesses.

Another proposal for fiscal year 2004 permits private collection agencies (PCAs) to support the IRS' collection efforts while affording full protection of taxpayer rights, allowing the IRS to devote resources to more complex enforcement and collection issues. PCAs are currently used by 42 state tax authorities and by other large federal programs. By eliciting the assistance of PCAs, the IRS should eventually be able to handle more collection cases at an earlier stage in the process—before the accounts become stale and non-collectible.

The fiscal year 2004 budget strives to improve the effectiveness of the Earned Income Tax Credit (EITC) program by ensuring that benefits go to those who qualify for them. The EITC program is aimed at rewarding those who work and helping families out of poverty. However, in 1999, between 27 and 32 percent of EITC claims—or between \$8.5 billion and \$9.9 billion—were paid in error. Congress has recognized this by providing a separate appropriation that has been used for EITC enforcement.

¹The United States Customs Service, the United States Secret Service, the Federal Law Enforcement Training Center, a portion of the Bureau of Alcohol, Tobacco and Firearms, and the Office of Enforcement.

As a result, the fiscal year 2004 budget requests an additional \$100 million to begin a new strategy for improving the EITC program. The IRS will begin to use an integrated approach to address potential erroneous claims by identifying cases that have the highest likelihood of error before they are accepted for processing and before any EITC benefits are paid. A key part of this strategy is to begin certifying taxpayers for the EITC. The IRS will seek to minimize the burdens on taxpayers by using existing databases and other sources of information to verify eligibility in advance. This integrated approach is designed to provide far greater assurance that EITC payments go to the individuals who qualify for the credit, without sacrificing the goals of the EITC program.

Fiscal year 2003 and fiscal year 2004 are key transition years for IRS core systems modernization efforts, as the foundation of our Nation's tax system is beginning to be replaced, building a bridge to provide interactive and improved customer service. The fiscal year 2004 budget provides \$429 million for the continuation of the Service's modernization effort in re-engineering business processes and developing new business systems to replace the antiquated and obsolete system.

In fiscal year 2003 and fiscal year 2004, IRS will roll out the first two phases of a multi-year effort to replace the main taxpayer database. This new database will provide accurate tax account answers on a real-time basis, enabling IRS to develop new approaches to simultaneously improve tax collection and taxpayer assistance.

As a partial result of the transfer of nearly 70 percent of the Office of Inspector General account to the Department of Homeland Security and the Department of Justice, the fiscal year 2004 budget proposes a consolidation of the Inspector General services at Treasury, the Office of Inspector General and the Inspector General for Tax Administration. While retaining those specific functions outlined in the Restructuring and Reform Act of 1998 (RRA98), the combined Inspector General for Treasury will be responsible for providing oversight to the remaining Treasury bureaus.

SERVING A CRITICAL ROLE IN THE FINANCIAL WAR AGAINST TERRORISM

The campaign to stop the financing of terrorism is a top priority for this Administration and this Department. Treasury continues to play a critical role in this vital effort. This work touches on several of Treasury's core functions, and involves many of our jurisdictions, offices and departments.

Treasury implements these functions through a number of mechanisms. Treasury serves as Chair of the interagency Policy Coordinating Committee, which is responsible for coordinating the day-to-day development and implementation of policies to combat terrorist finance. We have also just created an Executive Office of Terrorist Financing/Financial Crime under the Treasury Deputy Secretary, which will work with the International Affairs Terrorist Financing Task Force and with the deputation devoted to critical infrastructure protection and strengthening U.S. legal and regulatory protections against terrorist finance in the Office of Domestic Finance.

Treasury continues to play a critical role in the law enforcement and regulatory communities' fight against terrorist finance through the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control (OFAC) and the Internal Revenue Service Criminal Investigation Division (IRS-CI). These entities will report to, and in the case of IRS-CI work collaboratively with, the newly created Executive Office of Terrorist Financing/Financial Crime.

The Financial Crimes Enforcement Network (FinCEN) fosters interagency and global cooperation and serves as a link between the law enforcement/intelligence communities and financial institutions and regulators in fighting domestic and international financial crime. Their strategic analyses of domestic and worldwide money laundering developments, trends, and patterns provide U.S. policymakers a platform on which important decisions concerning terrorist threats can be made. The fiscal year 2004 budget provides FinCEN an additional \$6.8 million for administering additional requirements mandated by the USA PATRIOT Act of 2001 and subsequent regulatory requirements, including expanding the Bank Secrecy Act (BSA) to new industries, and accelerates efforts to enable electronic filing of BSA data more efficiently through the Patriot Act Communications system.

Through the FinCEN, Treasury continues to support the FBI's Terrorism Financing Operations Section, the Policy Coordinating Committee Action Group on Terrorist Financing, and the National Money Laundering and Terrorist Financing Strategy of 2002 (formerly the National Money Laundering Strategy).

The Office of Foreign Assets Control administers and enforces the U.S. government's economic sanctions and embargo programs against targeted foreign governments and groups that pose threats to the national security, foreign policy, or economy of the United States. Since September 2001, Treasury's Office of Foreign Assets

Control has frozen over \$36 million in terrorist assets in U.S. financial institutions. OFAC's designation and asset blocking process has served as the spearhead of the President's financial war on terrorism.

The Internal Revenue Service Criminal Investigation (IRS-CI) Division specializes in analyzing complex financial information and determining whether that information is in violation of tax laws, money laundering laws, and the Bank Secrecy Act. In addition, IRS-CI is heavily involved with the Joint Terrorism Task Forces (JTTFs), Operation Green Quest and similar partnerships focused on disrupting and dismantling terrorist financing. In particular, IRS-CI is focused on preventing the abuse of charities by those who support terrorism.

The coordination of Treasury's multi-faceted efforts to combat terrorist financing and other financial crimes, both within the United States and abroad, will be led by the newly created Executive Office of Terrorist Financing/Financial Crimes. This Office, in coordination with offices within the Treasury and other government agencies, will work to reduce the risk that the domestic and international financial systems are being misused by criminals and terrorists, and using these same systems to identify, block and dismantle sources of financial support for terror, money laundering, and other criminal activities.

This new office works side by side with the International Affairs Task Force on Terrorist Financing (TFTF), which was established shortly after September 11th to track and monitor countries' efforts to combat the financing of terrorism and to devise strategies to build an international coalition. The TFTF helps coordinate international designation of terrorists, which has resulted in a global total of \$124.9 million in terrorist assets being blocked. The TFTF coordinates Treasury's anti-terrorist financing efforts in the international financial institutions, multilateral forums such as the G-7 and G-20, and bilaterally with other finance ministries.

MAINTAINING THE INTEGRITY OF OUR NATION'S FINANCIAL SYSTEMS AND SAFEGUARDING OUR NATION'S CURRENCY

In fiscal year 2004, Treasury continues its responsibility to maintain the integrity of our Nation's financial systems and safeguard our Nation's currency.

The Financial Management Service will continue to improve the quality of Federal financial management, fully implement debt management services operations, modernize Government-wide accounting and reporting infrastructure, and progress toward an all-electronic Treasury financial system.

The Bureau of the Public Debt will continue its management and support of the applications and systems used to conduct Federal borrowing and debt accounting operations, re-enforcing its mission of providing high quality customer service to investors in Treasury securities. Public Debt's customers range from individuals with small amounts to invest, to the largest financial institutions, as well as the more than 200 Government trust funds.

The Office of the Comptroller of the Currency serves as the Administrator of National Banks, chartering new banking institutions only after investigation and due consideration of charter applications and supervising existing national banks through the promulgation of rules and regulations for the guidance of national banks and bank directors.

The Office of Thrift Supervision charters, regulates and examines Federal thrifts, cooperates in the examination and supervision of State-chartered thrifts and reviews applications of State-chartered thrifts for conversion to Federal thrifts. They also review applications for the establishment of branch offices.

The activities of the United States Mint and the Bureau of Engraving and Printing are vital to the health of our Nation's economy. These agencies share the responsibility for ensuring that sufficient volumes of coin and currency are consistently available to carry out financial transactions in our economy. They are also responsible for manufacturing cash products that not only foster domestic pride, but also promote respect and confidence in the world's most accepted currency.

The United States Mint receives no appropriation and, under its Public Enterprise Fund, operates in a business-like fashion that enables it to respond to the needs of retail commerce. In addition to producing a reliable supply of circulating coinage—including the newly designed coins of the 50 State Quarters® Program—the United States Mint will continue to fulfill its mission to produce the Nation's commemorative coins, medals, bullion coins, and other numismatic items, as well as its mission to protect the Nation's precious metals and other assets at Fort Knox and at other United States Mint facilities.

The Bureau of Engraving and Printing is in the process of redesigning our Nation's paper currency to counter the trend of computer generated counterfeiting. Building on past security features, the new design, known as NexGen, may begin

circulation in the \$20 note as early as fall 2003, with the \$50 and \$100 notes to follow 12 to 18 months later.

FOUNDATION FOR SUCCESS—THE PRESIDENT'S MANAGEMENT AGENDA

We continue to use the five elements of the President's Management Agenda as a guide to achieving Treasury's key priorities, and accomplishing the overall mission and goals of the Department.

For fiscal year 2002 and 2003, many of Treasury's accomplishments in implementing the President's Management Agenda were in the area of expanded electronic government. Specific efforts included:

- The Internal Revenue Service has made significant progress towards achieving the Congressional goal of having 80 percent of all tax and information returns filed electronically by 2007. In fact, as of May 9, nearly 43 percent of all returns were filed electronically. During 2002, IRS partnered with the Free File Alliance, a consortium of private sector companies, to provide free Internet filing of 2002 Federal tax forms for most taxpayers. IRS has also provided functionality to allow taxpayers to check the status of their refund on the web.
- In fiscal year 2002, the Financial Management Service issued 73 percent of all payments (666 million of 919 million) by electronic funds transfer. FMS also collected 79 percent (\$1.8 trillion of \$2.27 trillion) of all federal receipts electronically.
- In 2002, the Bureau of Public Debt introduced the Treasury Direct system, by which retail investors can purchase electronic Series I inflation-indexed savings bonds. This is the first step toward the Bureau's goal to convert all savings bond holdings to paperless form.

Treasury has also set the standard as the best in the government for improved financial performance, with all of its bureaus now closing their financial statements within 3 days after the close of each month and issuing audited fiscal year 2002 consolidated financial statements within 45 days after the end of each year.

CONCLUSION

Mr. Chairman, while I have served as Treasury Secretary for only a short time, I have already been deeply impressed by the intelligence, professionalism and dedication of the people with whom I have worked. This is especially true during these challenging times.

I look forward to working with you, Mr. Chairman, as well as members of the Committee and your staff, as we move into fiscal year 2004 to maximize Treasury's resources in the best interest of our country. I am hopeful that together we can work to make this Department a model for management and service to the American people.

Thank you again for the opportunity to present the Department's budget today. I would be pleased to answer your questions.

Senator SHELBY. Thank you, Mr. Secretary.

RESTRUCTURING TREASURY

Mr. Secretary, you are a new Secretary, relatively new—not new to Washington, though—at a Department that has undergone substantial institutional change since passage of the Homeland Security Department. With the transfer of the majority of Treasury's law enforcement missions, how has the Department reprioritized its other functions to better focus on its core missions? And how is that focus translating into the budget request and the DO modernization study?

Secretary SNOW. The restructuring of the Treasury Department as a result of the creation of the Department of Homeland Security and the transfer of so many of our enforcement functions has changed the Department in some fundamental ways, and those changes are reflected in our budget, Mr. Chairman. We have lost over 30,000 people, so we are a smaller Department. We have reduced the budget by over \$3.5 billion. And while the Department is smaller as a result of the Homeland Security transfers and the

transfer to Justice of a part of our functions, I think we are more focused. I think we have the ability because of this restructuring to put more concentrated effort on economic policy, which I think is a core part of what the Department does. That is really the central mission, as I see it.

Secondarily, of course, the direct responsibilities of the IRS bulk are much greater now. This will give me much more opportunity to focus on the effectiveness and fairness of IRS implementation.

Finally, terrorist finance, I see that as the third major area. I think our budget this year, Mr. Chairman, reflects those priorities very much.

Senator SHELBY. Mr. Secretary, I know you have lost a number of employees to Homeland Security, but you still have thousands of employees. Roughly, how many do you have?

Secretary SNOW. Well, we have a little over 100,000 employees, most of whom are in the IRS. The IRS is about 90 percent, I would say, of the people in the Department today.

PRESIDENT'S TAX PACKAGE

Senator SHELBY. I want to ask you a number of questions. The President's tax package included a proposal to eliminate the dividend tax, and the Senate followed suit by including a short-term elimination. What we have done, I think, overall has made investment a better choice for all Americans.

Mr. Secretary, if investment is critical to our economy, which I think we both believe it is, does it make any sense to penalize investment with an unnecessary tax like the dividend tax?

Secretary SNOW. Well, not in my view.

Senator SHELBY. Not in mine either.

Secretary SNOW. I am a strong advocate of lowering the taxes on dividends.

Senator SHELBY. How does repealing the dividend tax help to restore investor confidence in our securities markets, which we desperately need to do? And what effect does it have on the ability of individuals to rationalize risk in the markets? And, lastly, what effect will that have on corporate governance? Because on the Banking Committee we have had testimony that that could change the way a lot of companies operate.

Secretary SNOW. I think the dividend proposal is one of the most far-reaching and significant in recent tax policy because it will lower the cost of using equity capital. Today, the Tax Code is tilted because of the lower cost of debt capital towards greater reliance on debt capital. As a result, the debt-to-equity ratios in American companies are higher than they otherwise would be. So a first effect of the proposal would be to lower the cost of equity capital, encourage greater use of equity capital, and, thus, change the debt-to-equity ratios to be more conservative.

One major benefit of that is more conservative debt-to-equity ratios makes our firms less vulnerable, less stretched, during periods of economic downturn.

Senator SHELBY. It makes them stronger in a way, doesn't it?

Secretary SNOW. It does, Mr. Chairman.

EARNED INCOME TAX CREDIT

Senator SHELBY. I just want to get into the Earned Income Tax Credit for just a minute. The earned income tax credit compliance effort has experienced problems since its inception. We know that. I am interested in making sure that the initiative works properly. We want to make sure that it works for the people that it was intended to help, but I see no rationale for not pushing reform to eliminate the errors in payments to people who don't qualify or if there is an overlapping qualification, you know, a double hit, because if we are going to have a program such as the Earned Income Tax Credit, it ought to be run right. And \$9 billion, perhaps more, erroneous payments, there is no excuse for that in any situation, and I want to make sure that you have the money to put the software together or whatever you have to have to run this program right for the people who are receiving it but right for the taxpayers who are paying for it.

Secretary SNOW. Well, I appreciate that very much, and the numbers you cited in your opening statement are the very numbers that look to us to be about right; misapplication of funds are roughly one-third of the whole program.

But this is not an effort to do anything other than make sure that the benefits are made available to the right people and made available in a way that doesn't have us coming back with post-audit assessments and after-the-fact reviews and withholdings.

Senator SHELBY. If there are people out there, as Senator Murray mentioned in her opening statement, that aren't getting it but would qualify for it, reaching out to them and letting them know about it would make sense. You could pay for that additional 25 percent of people who are not getting it, as I heard in her testimony, by eliminating the mistakes and the fraud in the program.

Secretary SNOW. Mr. Chairman, that is our approach: to avoid what must appear to many people to be after-the-fact harassment, because we got it wrong in the first place.

I look at this in a very straightforward way: Get it right the first time, reduce the errors, and the system will function much better. People will have much more confidence in it if we get the criteria set right.

Senator SHELBY. I think this should be one of your top priorities. I hope it will be. That kind of money, it makes no sense to waste.

Secretary SNOW. Right.

EXECUTIVE OFFICE FOR TERRORIST FINANCING AND FINANCIAL
CRIMES

Senator SHELBY. Mr. Secretary, what is the mission of the newly created Executive Office of Terrorist Financing and Financial Crimes?

Secretary SNOW. This is to give us, Mr. Chairman, a more coherent and stronger point of attack on financial crimes, money laundering, and those sorts of things. We think that this new office will be organized to carry on these activities with more focus and be more effective.

Senator SHELBY. How does this interface with the other bureaus within Treasury that are tasked with similar missions?

Secretary SNOW. There is a close coordination between the Office of Foreign Asset Control (OFAC), which deals with the foreign assets and the designation of banks and financial institutions that are engaged in illicit activities, and the Financial Crimes Enforcement Network (FinCEN). They are coordinated.

Senator SHELBY. OFAC.

Secretary SNOW. OFAC and FinCEN and the IRS Criminal Investigations. It is sort of a matrix, but there is a coordination among them. And our General Counsel, David Aufhauser, serves as the sort of quarterback for these functions to make sure they are all well coordinated.

Senator SHELBY. Mr. Secretary, do you believe that the Department of Homeland Security has taken too much of what you have to fight financial crimes, investigating other crime? Or do you think you will have the resources?

Secretary SNOW. Mr. Chairman, I think we have all the tools that we had before in terms of the enforcement powers—the PATRIOT Act, other legislative tools, and OFAC—that we need. I think we will need to rely from time to time on other agencies, though, to do the actual on-the-ground enforcement and maybe some of the investigative work.

Senator SHELBY. Thank you, Mr. Secretary.

Senator Murray.

EARNED INCOME TAX CREDIT (EITC)

Senator MURRAY. Thank you, Mr. Chairman.

Mr. Secretary, let me go back to the EITC because I have some questions on that. I understand that you are requesting \$100 million and 650 FTEs in 2004 to launch this initiative. It is estimated that 25 percent of eligible families do not participate in this program, and only \$13 million of the amount you are requesting is targeted on bringing those eligible families into the program.

Your agency has claimed as much as \$9 billion in the EITC overpayments annually, but there is likely to be between \$10 and \$12 billion in payments that would be made if all working poor families were eligible.

I am curious why your agency is requesting so much additional funding to eliminate the overpayments and such a paltry additional amount to address the underpayments.

Secretary SNOW. Senator, we are requesting the funds that we think are appropriate to put in place the sort of processes that will address all the problems and address them effectively. The biggest problem is this criteria problem.

Senator MURRAY. It seems to me there are two problems. There is the problem in payments that are made that shouldn't have been, but there is also the problem in reaching out to the working families, 25 percent of the eligibles, who are not. Correct?

Secretary SNOW. Right. Let me ask Ms. Ressel, who has been working this issue very closely, to respond on that.

Ms. RESSEL. I think you are correct that there are two issues, and it is important to not overlook the first one. If you think about it in two parts, the first important part is to find eligible recipients. We have tried to work analytically with the people who are responsible for putting together this package; it is my understanding that

this is the first year of a 2- or 3-year plan on what we need to do with EITC.

Analytically, when you look at the investments of the \$100 million, the designers of the program tried to invest a certain amount of money into the infrastructure for the technology to make sure that the people who were eligible and didn't have an income problem could be matched through the technology and never have to audit them again.

Then in parallel, it is my understanding that IRS was trying to work with the United Way and do an outreach program for military families.

Senator MURRAY. Okay. Let me go into that, because there is only \$13 million for the outreach part, and I want to try and understand, Mr. Secretary, what your strategy is in reaching out to these working poor families to advertise, in media outlets, I assume it is, that working poor families are likely to see.

I have a copy with me this morning of CQ Today, which was from Friday, May 16th. It is Congressional Quarterly's online daily newsletter, and it has a nice picture of Senator Nickles on the front here talking about the dividend tax surviving the Senate. And in it is an ad on the earned income tax credit.

Now, the CQ, to get it you pay a subscription of \$2,430 a year. I think it is made free to some Capitol Hill offices, but it is mostly a newsletter that is targeted to lobbying firms and Government relations offices. And I don't understand how the use of money to advertise in this is going to help outreach to poor families who are devoting 20 percent of their annual income to subscribe to this.

Ms. RESSEL. We do not know when that happened, but we will ask the IRS to respond to you. We do know from our briefing in preparation for today that a number of the agencies included welfare-to-work, Health and Human Services, Annie E. Casey Foundation funds, that we have worked—

Senator MURRAY. Well, is this part of the funds that you are using for outreach?

Ms. RESSEL. I don't know. We will find out and get back to you.

Senator MURRAY. Well, if you could tell me precisely how much taxpayer money has gone into lobbying Congress—

Ms. RESSEL. For that one.

Senator MURRAY [continuing]. As this appears to be, rather than to outreach of that outreach money, I would like to know the answer to that.

Ms. RESSEL. We will find out.

Senator MURRAY. Okay. Let me also ask about the comment period, because 2 weeks ago IRS testified to our companion subcommittee in the House of Representatives that there would be a formal public comment period on this new process and draft forms would be required to be filled out by working poor families. And that makes sense since the IRS customarily has a public comment period for any major changes in procedures and forms.

However, we are now told that you may be planning to send out these forms within a few months and that no formal public comment period has been announced in the Federal Register. So I need to know, Mr. Secretary, whether the agency is changing their mind,

if there is going to be a public comment period, and how that will be done.

Secretary SNOW. Senator, that is really a matter for Mark Everson, the new Commissioner, to——

Senator MURRAY. Doesn't your agency determine whether there is a formal comment period?

Secretary SNOW. Yes, but as I was saying, he will have the lead on this. At this point, to my knowledge, no decision has been made about the notice or its publication. The new Commissioner wants to have a little time on the ground to review the initiative before he moves forward or we move forward with the notice.

I would say we would expect to have something fairly soon, but we have not set a date yet.

Senator MURRAY. Will there be a formal comment period? That is a pretty important issue when we are dealing with thousands of forms that are going to families that have never been vetted before.

Secretary SNOW. I don't know that we have reached a conclusion on that yet. I would want to hear the IRS Commissioner's recommendation.

Senator MURRAY. Could we get an answer back to the committee on that, please?

Ms. RESSEL. Sure. We will give you an answer. But I would like to talk to the IRS Commissioner first.

Senator MURRAY. Okay. I understand.

Well, I will tell you that last month the Acting IRS Commissioner assured me that your agency would be getting a thorough evaluation of the impact of this new process on EITC participation before you expand your effort to 2 million working poor households, and I want to ask again: Will your agency be getting a thorough evaluation on the impact of this process before we expand it to 2 million households?

Secretary SNOW. I think there is a major effort underway, an outreach program, to hear from taxpayers and taxpayer groups. Certainly we will want to draw broadly on taxpayer responses on this.

Senator MURRAY. Mr. Secretary, what we want to know is whether there will be information on the impact to the working families before we broaden this out to 2 million families and have a complete disaster—or maybe a complete success. Are you going to look at it first, as we were told originally, or not?

Secretary SNOW. Senator, yes, this matter is being studied pretty carefully, and I understand there is a pilot program underway right now.

Senator MURRAY. That was our understanding. There was a pilot program; we would look at the results of that before we expanded it to 2 million people. I am concerned now that before we ever look at the results, determine whether or not there was complete confusion on a sentence or a pause or a question or anything, that we then send it out to 2 million people and exacerbate a problem that we could solve by doing a pilot project.

Secretary SNOW. Senator, let me say, we are not going to put this out until we have great confidence that it will work.

EXTRATERRITORIAL INCOME (ETI)

Senator MURRAY. Okay. Well, we will be following this very closely. I agree with you we need to find tax fraud, but I also think we need to do it correctly; otherwise, we are going to create problems for a subset of people in this country that I don't think is very fair.

Let me move to another question. On April 1st, I sent a letter to the United States Trade Representative Bob Zoellick expressing my serious concerns regarding the Administration's support for simply repealing the Extraterritorial Income Exclusion Act of 2000 in response to a dispute with the European Union. I could have sent this letter just as easily to you. I know that international tax policy is part of your Department's responsibility. And I am very concerned that the Administration is proposing to leave U.S. exporters and U.S. workers at a severe disadvantage to our foreign competitors.

The Administration's position on the FSC/ETI issue is a job killer for my home State of Washington and the Nation, in my estimation. Given your background and your short tenure in the Administration, I would just like to hear your views on the issues and find out if the Administration is going to continue to support a full repeal of the ETI. Or do you have any comments on the various legislative proposals that are before us on this?

Secretary SNOW. Well, Senator, that is a matter we are beginning to get into with real earnestness. The President has made it clear that he would like to see legislation this year to deal with the World Trade Organization (WTO) issue. We are facing sanctions from WTO, sizable sanctions, unless we show progress on the issue. We are intent on trying to be helpful in moving a legislative vehicle. The cornerstone of it, though, must be something that is WTO-compliant, and from our point of view, doesn't prejudice American businesses. So we—

Senator MURRAY. In your opinion, should we just back off? I am hearing some of the Administration just say we should just back off and surrender our export incentives. Is that your opinion?

Secretary SNOW. Senator, I don't want to offer a premature view on our position. What I want to do is see legislation that will protect the interests of American businesses and avoid anything that is prejudicial to American businesses, while getting legislation through so we are WTO-compliant.

We have tried various things, two or three series of adaptations to try and get compliance; and they have all been found to be non-compliant. I think this time it is very important that we get compliance. But through our Office of Tax Policy, we are engaged in a serious and far-reaching set of discussions with American business to make sure we can come up with the very best set of proposals, and until we are a little further down the road with those discussions and those analyses, I think it would be inappropriate for me to say what precise form the legislation should take. But we are getting closer to the point where we are going to have to do that.

Senator MURRAY. I thank you, Mr. Secretary. I know my time is up. I just think it is really important that we do not back off and

surrender. I hear people saying they don't want a trade war. Well, I think it is the Europeans who have declared a trade war on this country, and I think we need to push back and find a solution because it is so important to so many people who have jobs in this country and depend on this.

Thank you, Mr. Chairman.

Senator SHELBY. Senator Byrd.

STATEMENT OF SENATOR ROBERT C. BYRD

Senator BYRD. Thank you, Mr. Chairman.

Mr. Snow, we have had very good relations in the past.

Secretary SNOW. Thank you.

Senator BYRD. And I look forward to working with you. I compliment you on being the new Secretary. You follow a line that goes back to the very beginning of the Republic, and, of course, the first Secretary was Alexander Hamilton, probably the greatest of all. And you will recall that he died on July 11, 1904—he died on July 12, 1904—1804, as a result of a duel with Aaron Burr, which took place the day before, on July 11, at Weehawken, New Jersey. And he lived through the night with excruciating pain, with his dear wife and seven little children around him, crying. He died on the 12th. A great Secretary. A great Secretary of the Treasury.

I just recall those things about Hamilton because I once wrote a paper on the great enigma, Aaron Burr. I won't go into that at this point except there was a good side of Aaron Burr. Of course, we know about the dark side. But there was a good side. He had a daughter named Theodosia, whom he revered, and, of course, she idolized her father, Aaron Burr.

PRIVATE COLLECTION AGENCIES

But so much for that. The IRS seemed determine to hire private debt collection agencies to pursue delinquent taxpayers. Did you know that the Romans did that also? Yes, the Romans tried that. And you may recall the latifundia. The latifundia gathered up farms, and the little farmers in Appenines migrated into the cities and joined the mob seeking free bread and theaters. Anyhow, it didn't work so well with the Romans, nor did the letting out of the taxes, the tax collectors. You might do well to go back and review the experiences of the Romans, out of the Roman Republic.

Two pilot projects—now we will get back to our own Republic, and this is a Republic. Two pilot projects in 1996 and 1997 were authorized by Congress to test the private collection of tax debt. The 1996 pilot flopped so badly that the 1997 project was canceled. Contractors used aggressive collection techniques and failed to protect the security of sensitive taxpayer information.

Even if privacy guarantees are built into the law, the IRS does not have enough personnel to monitor the work of contractors and to enforce privacy protections for taxpayers. In an age when private protections are under assault and identity theft is rising at a head-spinning rate, turning the duties of taxpayer collections over to private firms with limited accountability to the American people is just plain nuts.

If the President's budget does not request adequate funds, Mr. Secretary, for the IRS to do what is inherently a governmental job,

why is the Department not asking this subcommittee for more money? Why are you risking the privacy rights of the American taxpayers on a scheme that had already failed when the Department could simply request more money to hire additional IRS personnel to track delinquent taxpayers? So why is the subcommittee not being asked for more money for that purpose?

Secretary SNOW. Senator, I think the answer is that the Department felt that the resources of these very talented IRS agents could better be used on the more complex cases than the simpler cases that involve acknowledged obligations. That is what the private collection people will focus on. The so-called low-hanging fruit of the system will lead to a better use of the scarce resources of the Internal Revenue Service.

Senator BYRD. So, in essence, you are suggesting, I suppose, that it is cheaper to contract out those services.

Secretary SNOW. More effective, I think is the way I would put it, Senator. We have a new Commissioner at the IRS. Actually, he has come from OMB. Prior to that, he had been in the private sector. Mark Everson—

Senator BYRD. You won't hold that against him, will you?

Secretary SNOW. No, I won't. I have talked with Mark about this. He in a sense is being held by his own petard here because as an OMB person he helped to structure the budget of the Department of the Treasury. Now he is going to be forced to live with his own policies.

But he is convinced, Senator, that the budget that has been requested will allow for more effective enforcement of the Code and more effective collection of the revenues and be fairer to the taxpayers.

Now, Mark and I have scheduled a weekly meeting. We are going to continue to review this matter. We are going to continue to be open-minded and review this private collection activity. Ms. Ressel has told me about the mistakes that were made in the past that you have talked about here. If this isn't going to work, we will be the first to tell you that it doesn't work. The experience last time around was one that we need to benefit from, use to our advantage, and not make the mistakes of the past.

But, Senator, if we need more resources, I will be the first to tell you. If this project doesn't produce results, we will be the first to tell you as well.

Senator BYRD. The National Treasury Employees Union cites a cost analysis put together last September by former IRS Commissioner Charles Rossotti, and that analysis said that if the Congress would appropriate an additional \$296 million to hire additional IRS compliance staff, the agency could collect \$9.5 billion in tax debts annually. That is \$32 for every taxpayer dollar spent compared to \$3 for every \$1 paid to a debt collection agency.

This is a study performed by the Bush Administration, and if we are looking for the best value for the American taxpayer, why should the Administration be advocating a proposal that costs more and does less to protect the privacy rights of taxpayers?

Secretary SNOW. Senator, Ms. Ressel is much closer to this because she wrestled with these issues in coming up with this budg-

et. She is the principal, the CFO of the Department. So, Teresa, I am going to ask you to give the Senator the response.

Ms. RESSEL. Senator Byrd, your comment about the ratio is correct: Mr. Rossotti had asserted that it was about 30:1 if the revenue collection is done inside the agency—

Senator BYRD. Yes.

Ms. RESSEL [continuing]. And that if you use the collection agencies, that it would be a much different ratio.

My understanding of this proposal is that it will be for the simpler cases. From listening to Commissioner Everson's testimony before you the week before last was that his big theme was that if you were to add additional resources to the IRS—and that might be something that Mark thinks he needs and he will work out with Secretary Snow for 2005—that they would not be used for this particular issue.

And so it is my understanding that that is the rationale that they used. It may not make sense at all when you look at the ratios, but no matter how many resources you may add to the IRS incrementally, there will always be something that they can't cover. If you used that logic, then perhaps that is where the Commissioner and the IRS team basically look at this. They look at this as a very low-end issue relative to covering an item that, even if you added an additional \$1 billion, that they wouldn't dedicate the money to this. That is my understanding of the situation and the way they looked at the resources, sir.

Senator BYRD. Mr. Secretary, my time is up, but I have to say that I am very, very suspicious of the privatization scheme. It seems to be stretching pretty much across the board with the Administration. Congress needs to oversee it very, very carefully, and we will be watching and listening for the record that you intend to make here and for the information that you will follow up with to this subcommittee on this subject.

Secretary SNOW. Mr. Chairman, those are fair comments; we will keep you well advised on this. If it doesn't pan out the way we hope it will, we will be the first to acknowledge that. We have to acknowledge that in the past this didn't work out very well, and there are some reservations this time. We are hopefully going to make a success of it, and learn the lessons of the past. But if we don't, I commit to you we will acknowledge that.

Senator BYRD. Very well. Thank you, Mr. Secretary.

Senator SHELBY. Senator Specter.

STATEMENT OF SENATOR ARLEN SPECTER

Senator SPECTER. Thank you very much, Mr. Chairman.

Mr. Secretary, welcome to this subcommittee on your first appearance since being sworn in.

Secretary SNOW. Thank you.

ECONOMY

Senator SPECTER. Unanimously approved, that is a pretty good start with the United States Senate.

Mr. Secretary, we are on the verge, as you know, of passing a tax cut, and one of the questions which is asked of me continuously as I travel through my State is the impact on the economy. What

is the likelihood that there will be a significant benefit? And we know that we have a \$10 trillion economy. Over a 10-year period with inflation, it comes to about \$140 trillion. The President advocated a \$726 billion tax cut. I supported that. The House came in at \$550 billion, the Senate at \$350 billion. And I supported the President because I think it is worth a try. And he has formulated the plan, and I think we ought to give his leadership a try at what he has.

There have been a lot of contentions that there is a lot of posturing on all sides, one group playing to its base on one line, et cetera, and it has been one of the most contentious issues that I have seen in my tenure in the United States Senate.

Vice President Cheney was on hand to break a 50/50 tie on one of the amendments, and then he had to sit around for 2 hours while the managers' report was structured. This was the first time I saw a Vice President sit in a Senator's chair.

Senator Byrd, I have to question—I should have come to you—whether that was appropriate. Anybody who sits in a Senator's chair besides the Senator would get a fast escort by the Sergeant-at-Arms out of the chair. A Member of the House was in last week, sat down, and it was almost as if he was in the electric chair, he got up so fast when he was prompted.

But I mention the Vice President to demonstrate how close it is. You are a Ph.D. in economics as well as an L.L.B. and a corporate executive of great standing, and now Secretary of the Treasury. What is the best articulation that this tax cut at any figure—at the \$350 billion figure, which it appears to be—will have a significant impact on lifting up the economy?

TAX CUT

Secretary SNOW. Senator, the economy is in a recovery, but it is a weak recovery. The tax plan that I hope comes out of a conference soon will, in my view, give the economy a lift for a couple of reasons:

One, it will put more disposable income in consumers' pockets. As people have more money in their pockets, they tend to spend more.

This has a particularly important effect on small business because so many small businesses pay their taxes through the individual tax return—23 million of them—and those 23 million businesses will become more profitable because of the tax plan. As businesses become more profitable, they become more inclined to make capital expenditures. Our economy is weak is on the capital expenditure side, yet we have consumers staying pretty strong. We have a strong housing market. It is the business expenditures for capital and expansion that have been weak. Small business is the principal engine. So I would say that more money in people's pockets and making small business more profitable will lead to more spending and expansion.

There is also that provision immediately giving small businesses another \$75,000 a year of free cash flow. That will be helpful.

Then I would go to the dividend side and say that is important as well. To lower the costs on paying out equity capital makes equity capital more attractive, which should help the stock market.

We are now an investor society with half of the American households owning equities. A rising stock market will buoy the spirits of the American consumers and businesses.

I think this plan is well calculated to lift the growth rates of the economy by as much as one percentage point this year and another close to one next year, taking us from the sort of anemic 1.6 growth rates that we have today to growth rates that are up in the mid 3's. Once we get to the mid 3's, then we begin to move back up towards a full employment economy.

Senator SPECTER. If the cut had been or were to be \$726 billion instead of \$350 billion, what greater percentage increase would that project?

Secretary SNOW. The way the Congress has structured the provisions in the package, it seems to be moving through both the House and the Senate. It is front-loaded in the sense that it has a lot of the impact that the bigger package would but it has a shorter period of time, and there are sunsets, which will have early-year impacts. In fact, in some ways it has been front-loaded to have more impacts in the early years. So for 2003 and 2004, the way it is structured, I think in both the House and the Senate, could have more impact in the early years than the initial package.

Senator SPECTER. So you are saying the \$726 billion would not necessarily have given a greater boost?

Secretary SNOW. I don't think it would have had a discernibly greater boost in the early years. I think it would have a greater boost for economic growth over the full period. Sure, the bigger, the better, as far as I am concerned, Senator. The way it has been structured, I think you will get most of the benefits, even though the numbers have come down. But I think to get the full benefits, it will be incumbent to come back in a couple of years and move those dates out. The tax provisions that sunset in 2005, and so on, I think should be made permanent, or at least added years to them.

PRIVATIZATION OF TAX COLLECTIONS

Senator SPECTER. Mr. Secretary, I would pick up just for a moment on what Senator Byrd said about privatization of collection. I opposed an amendment which would have prohibited the Treasury Department from going to private collection agencies because I think it is a matter that you ought to decide. We ought not to micromanage your Department on that particular matter. But I have a concern that a private collection agency may engage in tactics which a governmental agency would not. It is analogous to a quasi-judicial function. Some private collection agencies do things which really ought not to be done. They may be within the letter of the law and sometimes they are not even there; whereas, a governmental agency is going to have a little different perspective, try to collect debts but do so in a fair way. So I urge you to keep a close watch on that particular aspect.

I do share a concern with the power of the Federal Government and the Department of Justice and their Civil Division, and you have got a lot of lawyers in the Treasury Department, and you are a lawyer yourself, as some of us are on this panel. There would be good reason to think you would have enough muscle, skill, and ex-

pertise to do the collections. But if you are determined not to, take a close look at the practices the collection agencies use.

Let me ask as my final question—I am under a minute now—as to the \$133 million to expand efforts to enforce fair compliance among high-income taxpayers and businesses. What do you expect there?

Secretary SNOW. Senator, this is a matter that I intend to spend a lot of time on with Mark Everson, the new IRS Commissioner. What we expect is that high-income people and businesses will be held to the same tough-minded enforcement standards that the populace at large is. Over time, the clever tax avoidance schemes have become more and more complicated, more and more involved, and require more skilled and dedicated efforts to penetrate them. This is an effort to make sure we penetrate those clever tax avoidance schemes that are used by corporations and high-income people in a purposeful way and make sure that they are paying their fair share of the tax burden as well.

And on your prior point, I am in total agreement with what you and Senator Byrd said. We are going into the private collection activity wary of the risks, concerned about the potential problems that you and Senator Byrd alluded to, and committed to doing our very best to avoiding them. But if they are unavoidable, if they materialize, then we are going to be the first to say this doesn't work and this is the wrong way to go.

FLAT TAX

Senator SPECTER. Mr. Secretary, let me ask you a question for the record, which is an involved question, which I would appreciate your study and response to, and that is on a flat tax proposal. The Senate passed a resolution to push ahead with our Finance Committee and our Joint Economics Committee with analysis of a flat tax. And the model most frequently cited is the Hall-Rabushka model, two professors at Stanford.

Secretary SNOW. Right.

Senator SPECTER. And I believe the flat tax has never really been considered. I put a bill in back in the spring of 1995, and others have proposed it, and I would be interested to see a study—I was about to say “a serious study,” but I know any study you do will be serious. And let us respond to this subcommittee with what you think, because there is an occasion, after all the problems we are having with the tax cut, and we are nibbling at the edges and barely doing that, it is time we really gave a serious line of analysis. And I would appreciate it if you would undertake that, Mr. Secretary, for your Department.

Secretary SNOW. We will do that, Senator, and get back to you on that.

Senator SPECTER. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

ECONOMY

Senator SHELBY. Mr. Secretary, I want to talk to you a little bit about the economy. We have the largest economy in the world. I believe the Japanese is second and the German economy is number three. Is that correct, sir?

Secretary SNOW. That is right, yes, sir.

Senator SHELBY. The Japanese economy is sputtering along. They have deep problems, as we both know, in the banking sector that they have not really addressed.

The German economy is the locomotive of Europe, has been and probably will be. I saw the other day where it had gone into a recession, the numbers. Is that correct, sir?

Secretary SNOW. Yes, Senator, it is. They reported negative growth rates for two quarters in a row.

Senator SHELBY. What is the status of the Japanese economy? Is it growing or is it sputtering, but is it growing?

Secretary SNOW. It is growing, but modestly. I have just returned from meetings with the G-7 and had a bilateral discussion with Minister Shiokawa, the Finance Minister of Japan. He indicated that they would have positive growth for their fiscal year, which begins April 1, but that it would be in all likelihood less than 1 percent.

Senator SHELBY. Our economy seems to be uneven all across the country. It depends, in my State of Alabama, we have got counties with 3 percent unemployment, 3.5, 4, and then we have some much higher.

Secretary SNOW. Right.

Senator SHELBY. But I see that around America.

Secretary SNOW. Yes, I agree. It is uneven.

Senator SHELBY. How do you see our economy growing? We are in the second quarter of the calendar year now. Will it pick up in your estimation, in your judgment, remarkably so? And I am not talking about a hot economy. I am talking about a movement toward an economy where people are hiring again, where managers have confidence that they are going to sell their products and so forth. Do you think that we will pick up by the fourth quarter of this year?

Secretary SNOW. Senator, I think we are in a recovery with many elements of a stronger recovery in place: low interest rates and high productivity, evidence in the first quarter that corporate profitability is returning, and of a very good housing market, which has helped offset some of the adverse effects of the stock market.

Senator SHELBY. Without the housing market, without low inflation and low interest rates, the economy wouldn't be where it is today, would it?

Secretary SNOW. Absolutely. Those have been keys to our success, and the consumer who has stayed in the game continues to be quite engaged in spending money.

I think, Senator, that the elements are there for a good recovery in the second half. I think the tax plan, if it gets adopted here soon, will be a real plus and will add to the growth rates. I would look to growth rates in the fourth quarter getting back up towards where they should be.

Senator SHELBY. Two and a half percent?

Secretary SNOW. Two and a half to 3 percent could well be the number.

Senator SHELBY. A 2.5 percent growth rate, although we would like it higher, would be an improvement.

Secretary SNOW. A very marked improvement—that is that 1 percent pick up that I said I think is in the cards for us.

Senator SHELBY. I saw where the 10-year bond, I believe, closed yesterday at 3.50?

Secretary SNOW. Lowest in 40 or 45 years.

Senator SHELBY. Now, that bodes well for people who are refinancing their home, their businesses, and so forth, does it not?

Secretary SNOW. It absolutely does. Therefore, if we can get these low interest rates and some pickup in aggregate demand, I think the economy could begin to make a nice, strong recovery. I would also mention, Mr. Chairman, the fact that corporate America, which in the late 1990s was expanding a lot, growing, merging, and so on—

Senator SHELBY. Created a lot of capacity.

Secretary SNOW. Created a lot of excess capacity, and we have excess capacity hanging over a number of industries today. We have corporate America leaning out its costs and becoming much more productive, learning to do more with less. That is hurting us on the employment numbers. But when the aggregate demand picks up, I think our corporate sector is poised to have much higher profitability, and as they get higher profitability, then I think we are going to see the expansions begin.

Senator SHELBY. Mr. Secretary, we have talked about this before, with another hat on, as Chair of the Banking Committee. We are very concerned about investor confidence, the erosion of investor confidence in our capital markets.

Secretary SNOW. Right.

Senator SHELBY. We have a new SEC Chairman, Bill Donaldson, that I have great confidence in at this point in time. But I don't see the investor confidence returning to the marketplace yet, yet we know that approximately 100 million Americans, more or less, are investing, directly and indirectly, in our capital markets—bonds, stocks, and so forth, through pension funds, through 401(k)'s and everything else.

If people don't have confidence in the corporate sector, in our accounting profession and so forth, how do you turn that around?

Secretary SNOW. Senator, I think that corporate behaviors are changing in a very positive way. With your work on the Banking Committee, and the new legislation that came through there in the wake of the corporate scandals—the changes in the New York Stock Exchange and in Nasdaq rules—the fact is that virtually every corporation in America has gone through a self-analysis to determine whether it is living to the highest standards of corporate governance.

I think the corporate sector is getting its own house in order. That needs to continue with the corporate sector taking the responsibility for making sure its conduct is of the highest order.

Senator SHELBY. That honesty and ethics matter, right?

Secretary SNOW. That honesty and ethics are at the core of things. I would add a thought on the dividend proposal. If something like the President's dividend proposal is adopted and we go to zero tax on dividends, I think it would have far-reaching effects on corporate behavior.

Senator SHELBY. I asked you that question earlier.

Secretary SNOW. You did, and I am going to get back to it now. Companies that pay dividends have to earn cash, they can't pay dividends through financial manipulation. They have got to do it the old-fashioned way. We still have laws against counterfeiting. What will happen in a world in which dividends aren't taxed the way they are today is that companies will pay more dividends. As the investors see companies pay more dividends, they are going to reward dividend-paying companies. That will encourage companies to do the right things: to focus on free cash flow, to manage their businesses for the investors so they can pay dividends, and then dividends will become a much bigger part of the story of corporate America.

As that happens, I think it will go a long way to restoring confidence in corporate behaviors. I think it could lead, Mr. Chairman, to a dramatic change in corporate behavior.

Senator SHELBY. And the way people look at stocks, right?

Secretary SNOW. And then the way people look at stocks, exactly.

ACCOUNTING PROFESSION AND CAPITALISM

Senator SHELBY. How important, Mr. Secretary, is the accounting profession to all of us, the capital markets, the publicly traded stocks? How important?

Secretary SNOW. They are the bedrock foundation of our confidence and trust, and capitalism really rests on trust. Investors can't dig into the numbers. They have got to trust the people who do the numbers. Trust is absolutely at the center of a well-functioning market economy. There is a huge responsibility that the accounting profession has as the guardian of the numbers, the custodians of that fundamental trust.

Senator SHELBY. And once it is lost, it is hard to get back.

Secretary SNOW. Senator, that is what we are experiencing today. One reason I think our markets are suffering today, and are so much less buoyant, is that trust has been eroded. It takes time to build back trust. What you have done in the Congress I think is very helpful. What the Securities and Exchange Commission (SEC) is doing under Chairman Donaldson is very helpful. I think now what the corporate sector is doing and what the oversight board will do will help restore trust.

But I think we need to be clear that trust has really been put in peril, been jeopardized. I am convinced one of the reasons this economy isn't performing better is just that. In fact, in Europe, the G-7 Ministers have some of these same problems in their corporate sector. Now they are beginning to look at what you did in the Banking Committee and say we need rules on corporate governance like those rules to restore trust, to create a foundation of trust.

GLOBAL ECONOMIES

Senator SHELBY. Secretary, lastly, for this round, if the Japanese economy is sputtering along, the German economy is in recession, and we are so interdependent on trade both ways, if they continue to sputter, that has an effect on us. How do you view their economies—I know you look at it; you have to—to be picking up? Or would you rather save that?

Secretary SNOW. No, I would like to answer that. One of the themes that I have been taking to the G-7 countries is the need for our interdependence. Our prosperity depends on yours, and yours depends on ours. We are working hard to get the American economy to grow faster, and you need to grow faster, too. Your growth rates are even lower than ours. Your growth rates are about half of ours and your productivity rates are much lower. Can't we come together in a consensus that promoting economic growth is in all of our interests?

I am pleased to say, that in Germany, the Schroeder administration is now pushing some major tax reforms. In France they are pushing some significant pension reforms. In Japan, of course, banking reforms are a major theme and deregulation of some of their retail and other things. It is more than monetary and fiscal policy, as important as they are. Well-functioning economies also look at the microeconomic characteristics and create open and free flow of resources and make sure that things like their pension plans don't exact too large a burden on the total fiscal situation of the country.

I am encouraged that Germany, Japan, and France are taking seriously this need for growth and are addressing these fundamental problems. But they are looking to us, too, Mr. Chairman.

Senator SHELBY. But isn't the U.K. economy one of the best in Europe?

Secretary SNOW. The U.K. economy is probably the best major economy. Canada continues to perform pretty well. But as you said, Japan is viewed as the engine of Asia and Germany as the engine of Europe, and they are both sputtering.

Senator SHELBY. Thank you.

Senator Murray.

ECONOMIC SANCTIONS AGAINST IRAQ

Senator MURRAY. Mr. Secretary, Iraq has been under international economic sanctions now for more than a decade. The sanctions have stopped numerous business deals from going forward. These business deals were negotiated by Saddam Hussein's government, and some of these deals were blatantly negotiated to undermine the sanctions regime.

Can you tell us what the Administration's position is on these business deals that were negotiated by Saddam Hussein's regime? And does the Administration believe the new Iraqi Government should be bound by Saddam Hussein's commitments?

Secretary SNOW. Well, the Administration is very much of the view that the sanctions should be lifted, the oil sanctions should be lifted, and the general sanctions should be lifted to allow the Iraqi economy to get back on its feet. It is very important, I think, to recognize just how much damage the Saddam regime did to the people of Iraq. The economic institutions of that country were hollowed out and significantly undermined during that regime. The standard of living of the country fell. They had negative growth rates for nearly two decades. What we are dealing with in Iraq today, in terms of the rebuilding and reconstruction, are not the results of a 3-week conflict, but really nearly three decades of mismanagement and misrule.

We are hopeful that our—and Treasury is very much, Senator, involved in this effort with a number of advisers over there right now looking at the question of setting up a central bank. Iraq has not had a central bank. Their central bank was really an apparatus of the dictator's regime. They haven't had a private banking system—they had a command-and-control banking system.

They don't have a budget. They haven't had a budget in any number of years. They don't have a set of national account statements, and they have a fairly chaotic currency.

There is an enormous amount of this foundational work to be done.

Senator MURRAY. But what I specifically wanted to find out from you was whether the new Iraqi Government should be bound by Saddam Hussein's commitments, and let me give you an example. Saddam Hussein's government negotiated a deal with Airbus to purchase five aircraft, and they paid a \$10 million deposit to Airbus for that aircraft. And I want to know whether the Administration believes that Iraq's new government should honor Saddam's Airbus purchase. And if not, will the Administration call upon Airbus to return the \$10 million to Iraqi people?

Secretary SNOW. Senator, I think that is really a question that ought to go to the State Department. I am not really knowledgeable enough on the treatment of those issues.

Senator MURRAY. Well, but I understand you were just at the G-8 conference in Europe, and I am certain you discussed some of these issues over there. Was there any talk about these commitments that had been made and how to—whether or not we should be demanding that that money be returned?

Secretary SNOW. There was discussion of the issue of the debt. There was a discussion of how to deal with the debt going forward. Iraq has very heavy debt obligations, estimated at \$80, \$90, to well over \$120 billion in an economy that is, of course, very small relative to that. So those debt levels aren't sustainable.

The G-7 Ministers decided that we needed to look at that situation. We recognized that debt repayments cannot be expected for some considerable period of time, and we agreed to take measures to quantify that debt. There is a group called the Paris Club, which is the significant creditor nations of the world, that meets in Paris and has a process for working through sovereign debt that is large relative to its sustainability. And the Paris Club has been asked to assess the situation and come up with suggestions on what should be done with regard to that debt.

The Ministers asked the International Monetary Fund (IMF) to do an assessment of the non-Paris Club debt—debt that comes from parts of the world that are not members of the Paris Club—Central Europe, for instance. The IMF has begun that.

The debt issue was clearly on the table. I think there is a recognition that a lot of that debt is going to have to be reworked one way or another.

Senator MURRAY. Well, can you answer the question specifically about contracts that had been made? Airbus is just one example of a number of business deals that were negotiated by the regime, and I just think Congress would be very troubled to see U.S. funds

to reward those who supported Saddam Hussein and worked to undermine economic sanctions.

Secretary SNOW. Senator, yes, I see where you are coming from. That issue did not come up at the G-7 Ministers conference.

Senator MURRAY. Let me just ask you, can you assure this subcommittee that U.S. funds will not be used to honor business deals negotiated by Saddam Hussein's regime?

Secretary SNOW. Senator, I think that really is a question for Colin Powell, the Secretary of State. I am not in a position to respond. I am sorry.

REBUILDING IRAQ

Senator MURRAY. All right. Well, again, let me go back to some of the other issues that you must have discussed at the Ministers meeting. One of the issues of concern to the Appropriations Committee is the anticipated long-term costs of rebuilding Iraq. We have been told that there will not be another supplemental request for Iraq this year. And if you could, share with us what the Administration's latest thinking is on the participation of the United Nations and other countries that did not join the coalition in the Iraqi rebuilding efforts. And did you discuss this issue with your G-8 colleagues over the weekend?

Secretary SNOW. Well, as I mentioned, we discussed the debt issue, which is an important issue for the rebuilding of Iraq. We did discuss a donor conference and set in motion some steps to set up a donor conference later this year, which I think can be important.

We also talked about the vesting of the assets of the Saddam regime so that they could be made available for the benefit of the Iraqi people. Assets of Saddam and the regime are found in the banking system and financial system of a number of countries around the world. The United States has taken a lead in getting countries to go after those assets, and in effect, seize those assets, and then make those assets available to the Iraqi people for the rebuilding process.

The United States vested, pursuant to a Presidential Executive order, about \$1.7 billion of Iraqi assets that had been held in our banking system. By vesting, I mean we seized them in the name of the Iraqi people for the rebuilding of Iraq, and for the benefit of the Iraqi people.

There are maybe another couple of billion dollars around, maybe more, and we would like to make sure that money is seized and made available for the benefit of the Iraqi people as well. So that subject was discussed, and there was broad agreement on the part of the Ministers that they would pursue that same strategy that we have pursued.

Senator MURRAY. Can you give this committee any estimate of what the Administration hopes the international community will contribute to Iraq?

Secretary SNOW. I don't think we have an estimate of that. I think that, just as in Afghanistan, there will be a good response. I think the response there was close to a billion dollars, \$900 million. Iraq is bigger and has bigger problems, so I would hope the donor fund would be even larger.

But I think we have to recognize that the principal source of funding for Iraq for the future will be the Iraqi oil monies. The sooner that the oil flows can resume, the better. Iraq, unlike Afghanistan, is an inherently very wealthy country if those oil resources are put to good uses.

So I am hopeful that the oil will flow soon and that the volumes will come up back to the old levels.

Senator MURRAY. The estimates on the oil flow are that it is going to take a while.

Secretary SNOW. I think it will take some time. I am not an expert on that, but I see no reason from what I know about it that it can't get back up to 2.5 million barrels a day.

Senator MURRAY. So in your discussions over the weekend, did you sense that the donor conference was something that would be accepted and we would see contributions from—

Secretary SNOW. Yes, I did, very much so.

TAX BILL

Senator MURRAY. Let me ask just one final question, Mr. Chairman, on the Republican tax bill in the Senate that just passed last week. There is a provision that taxes Americans who are working overseas by \$35 billion, and I supported the Breaux amendment that tried to strike that provision from the bill because I think that when American workers go abroad, they are ultimately followed by exports from the United States to the benefit of our workers who are here at home. And I wanted to find out from you whether you supported that \$35 billion tax increase on Americans working abroad. And do you believe this provision will reduce U.S. exports?

Secretary SNOW. Well, that was not in the original proposal that we sent to the Congress. It found its way into the Senate Finance bill, I am told, to create an offset. The offset allowed the legislation to move forward within the \$350 billion budget constraint that was established through negotiations among the various Senators.

Senator MURRAY. I know how it got there. I was just wondering whether you supported it.

Secretary SNOW. I don't think we have taken a position on it. We saw it as an accommodation to make possible the passage of the legislation. I am told that there is very little prospect of it surviving a conference.

Senator MURRAY. Thank you very much, Mr. Secretary, Mr. Chairman.

Senator SHELBY. Senator Byrd.

DEFICITS

Senator BYRD. Thank you, Mr. Chairman.

Secretary Snow, during your recent appearance on May 11 on "Meet the Press," you differentiated between deficits during times of full employment and deficits during times of under-employment. You suggested that, depending on the state of the economy, deficits are sometimes good, sometimes bad.

On the other hand, the Administration has advocated a belief that tax cuts are good no matter what the state of the economy or the Federal budget may be.

In 2001, the Administration said that we need tax cuts during times of full employment. In 2003, the Administration said we need tax cuts during times of under-employment. In 2001, it said we need tax cuts because of budget surpluses. In 2003, it said we need tax cuts because of budget deficits.

How do you sleep at night?

Under what economic and budget conditions would this Administration not advocate tax cuts?

Secretary SNOW. Well, Senator—

Senator BYRD. I understand we are going to have them every year now. It is going to be a perennial thing.

Secretary SNOW. I think, Senator, that given the level of the tax bite in the United States, that a good case can be made for tax rates that are lower than the tax rates that will result from this round of tax relief.

Senator BYRD. You are not answering my question.

Secretary SNOW. Well, I am getting to it, though, Senator.

Senator BYRD. It takes a long time.

Secretary SNOW. I don't mean to do that. The tax rates, as I recall, back in 1992 were about, on the high end, 31 percent; in 1986, they were 28 percent. I don't see anything wrong with trying to get tax rates somewhat lower and somewhat flatter. Obviously, there is a point at which further lowering of taxes will not serve the long-term interests of the economy, but we are a long way from that, I think.

Senator BYRD. But in the context of news reports that this Administration will seek new tax cuts every year, are there any circumstances, as far as you can envision, in which the Administration would view tax cuts to be risky or unwise?

Secretary SNOW. Well, Senator, what I think the news talked about was the fact that some of the tax relief that has been provided will be expiring. Therefore, there will be a need to go back and address that in the out-years. I think even under the Senate proposal that is being talked about now, some of those tax reductions will expire in 2005 and 2006. If they are good tax policy—and I think they are—then it is important to come back and make sure they are a permanent part of the Tax Code.

So I think clearly there is going to be need for further tax legislation in the years ahead.

Senator BYRD. But not necessarily tax cuts?

Secretary SNOW. Well, the legislation that would deal with those problems would be legislation to avoid tax increases, because there would be a series of tax increases going into effect. I am not aware of any proposals that are currently being contemplated by the Administration for tax cuts. I think we are focusing all our attention now on getting this package through the Congress.

Senator BYRD. Temporary tax cuts are being advocated by the President. It results from using reconciliation. But is there any level of deficit that this Administration would view as excessive? The Administration has said there is no particular line in the sand with regard to how high the Nation's budget deficits can grow before they would begin to worry the Administration. The OMB Director reiterated this belief last January when he said that budget deficits at 3 percent of GDP were nothing to hyperventilate about.

Yet the European Union not only requires its member states to keep their budget deficits below 3 percent of GDP, but the European Union Ministers can punish member states for breaking those deficit limits. Either the European Union places too much emphasis on budget deficits, or we place too little.

To what level would the deficit have to grow before the Administration would begin to hyperventilate? His word. The person who used that word, he is not necessarily the author of it, but he is not going to be around very long.

Secretary SNOW. Well, Senator, obviously, our view is that deficits are unwelcome. We don't like deficits. We want to get back into balance, and the sooner the better.

But these deficits are manageable in the sense that they are not large relative to our earning power. They are not large relative to our Gross Domestic Product (GDP). Importantly, they are coming down with time. They will be around 3 percent this year, 3.5, coming down over time to well under 1 percent. I think if the receipts that would come back into the Treasury were properly accounted for, you would be in balance within this budget cycle.

Senator BYRD. So you don't see hyperventilation as something that is imminent?

Secretary SNOW. No, I don't, Senator.

Senator BYRD. Too bad. I don't know what my little granddaughter and great-granddaughters will think about this. But you and I will probably not be around.

Secretary SNOW. In recent weeks, the President has reiterated his belief that the best way to address the deficit and move toward a balanced budget is to encourage economic growth. I believe you said on "Meet the Press" that ideal growth would be 3.5 to 4 percent. But even though the OMB is projecting economic growth for 2004 at a healthy 3.6 percent, budget deficits over \$300 billion are still projected for that year.

Assuming the President's policies are enacted into law, how fast does the economy have to grow, would you say, in order to finance the President's budget and tax cut proposals?

Secretary SNOW. Senator, if we can get the economy up to the 3.5, 4 percent level, we will put millions of people back to work. That is, I think, the first priority. We have a fiscal deficit, but we also have a jobs deficit today. I think the immediate priority is focusing on that jobs deficit—that growth deficit.

I am confident as we get this economy rolling again that the fiscal deficit will come down. It will come down because there will be more government tax receipts as more workers pay income taxes, as small businesses expand and pay additional income taxes, and as corporate profits rise. But we also have to watch spending. It is a combination of good economic policies to keep the economy strong that brings in more government receipts and good, reasonable tight spending controls. If we do that, Senator, I am convinced that we will have deficits that are modest, which will recede with time, and will not cause any adverse effects on interest rates or private capital formation.

We can never be indifferent to deficits. They really do count. But the real concern about deficits is that they will raise interest rates, crowd out private capital, and slow long-term growth rates. In all

honesty, Senator, I don't think that is a current concern. Our interest rates are at their lowest level in 40 or 45 years. But I am with you 100 percent on the need to be extraordinarily watchful of long-term deficits that get built into the financial fabric of the country. That we have to avoid at all costs.

DEBT LIMIT

Senator BYRD. My time is past expiring. During your May 11 appearance on "Meet the Press," Tim Russert asked you if the Congress should vote to lift the debt ceiling before approving any new tax cuts. And you responded, "No, no, the two are really different." And yet with a \$340 billion to \$400 billion deficit projected for the current fiscal year and an even higher deficit projected for the next fiscal year, the United States will have to borrow money to pay for any new tax cuts. That is a budgetary fact, a kind of very, very plain one.

Unless we raise the debt limits, how can the Treasury Department borrow the money to pay for the President's proposed tax cuts?

Secretary SNOW. Well, Senator, lifting the debt ceiling is an immediate and important issue. It is something that I really urge the Senate to do, and do before the recess because we are running up against the limits that we have. But my point to Mr. Russert was that the debt of the United States is the product of a number of decisions that have been made in prior years having to do with our entitlement programs, spending programs, and so on. It is not directly connected with this year's tax proposal.

Senator BYRD. Finally, if I may just end this line of questioning, and my time is running out. You said during your May 11th appearance on "Meet the Press" that the recession would have been a lot deeper, it would have been a lot harsher, it would have been a lot worse but for those 2001 tax reductions that the President was behind.

Absent a Dickensian "Ghost of Christmas Future" that visits the Treasury Department in the dead of night and shows you the future of tax cuts past, how does the Administration know what would have happened had there been no 2001 tax cuts? With so many unknown variables to which you refer in an \$11 trillion economy, how do we know that those tax cuts had any real effect at all?

Secretary SNOW. Senator, the best answer I can give you is my own experience in business and seeing where the economy was heading in the last half of 2000 and in 2001. I will never forget sitting in my office in Richmond, Virginia, when the reports of the CSX transportation subsidiaries came in: the railroad car loadings way down, the barge loadings way down, the truck loadings way down, ocean container shipping way down, the logistic business way down. I called the heads of these businesses and I said, "There must be something wrong, and we need to meet and talk about this." "No," they said, "these are the numbers." They were confirmed in August and they were confirmed in September.

I remember going, Senator Byrd, to a business summit meeting that the President-elect called with business leaders and economists and academics in Austin, Texas, in January of 2001. There

was a roundtable discussion about the economy and the outlook, and when it was my turn, I was very straightforward. I said, "Mr. President, you are inheriting a recession, and it is going to be a deep one unless action is taken soon to deal with it."

So, Senator, I really do feel that the action that the Congress took in 2001 headed off what could have been a very serious, very deep-seated recession.

In fact, the industrial sector fell to 20- or 30-year lows in terms of output levels during that period. It was a deep, deep fall-off in economic activity, and the industrial sector is still working its way through those issues.

I recognize what you are saying. Economics isn't an exact science, but my own personal experience complements what little I know about economics to suggest that those 2001 tax reductions were very important.

Senator BYRD. And helped to lead to gargantuan deficits.

Secretary SNOW. Senator, if the economy hadn't begun to come back as it did, government receipts probably would have been even lower. Government receipts have really been down from where they were back at the end of the 1990s. There has been a dramatic fall-off in government receipts, tied to, I think, primarily the weakening of the economy.

Senator BYRD. Thank you.

TERRORIST FINANCING

Senator SHELBY. Thank you, Senator Byrd.

Mr. Secretary, the Office of Foreign Assets Control (OFAC) is the Department's lead agency for identifying terrorist financing and denying terrorist groups access to financial markets. What efforts have been made to garner the commitment of other nations to participate in this effort, in other words, to get a handle on the terrorist groups' access to financial markets?

Secretary SNOW. Senator, we are engaged in extensive efforts to do just that, led primarily under the broad direction of David Aufhauser who I mentioned earlier. But we have a major outreach program with dozens and dozens of countries with whom we share intelligence, coordinate information, and work in a coordinated way to try and interdict these flows. OFAC has done a number of designations of foreign banks. Once those designations are made, the bank can no longer have dealings with the United States banking system. We coordinate those activities with the foreign finance ministries and enforcement people. There have been a significant amount of assets seized from bank accounts of people who we suspect of terrorist activities or supporting terrorist activities.

So it is a major and a full-time effort.

Senator SHELBY. The French, are they cooperating?

Secretary SNOW. Yes, Senator—

Senator SHELBY. And to what extent?

Secretary SNOW. We have had discussions with the French about the need to be part of this. They have committed to using their official banking system and enforcement authorities to trace and track the illicit funds that finance terrorism.

Actually, Senator, we have good, broad-based support for these initiatives.

Senator SHELBY. Does that include Cyprus?

Secretary SNOW. I would have to check the list.

Senator SHELBY. And a lot of the Middle Eastern countries, including Jordan.

Secretary SNOW. Right.

Senator SHELBY. Mr. Secretary, a lot has been written about seized Iraqi funds. You recently called upon all nations, Mr. Secretary, to join the U.S., and your words were "find, freeze, and return Iraqi money for the Iraqi people and their future."

Given that Saddam Hussein's wealth has been estimated to be anywhere between \$2 billion and \$40 billion, recovering this money will certainly help in the rebuilding of Iraq. However, given that a number of countries and private entities around the world have laid claim to a portion of those assets, if not all, how is your request to return this money to the Iraqi people being received overseas?

Secretary SNOW. I think it depends a lot on who we are talking to. But among the G-7, it has been very well received, and I will submit to you for the record an assessment—

Senator SHELBY. We would like that.

Secretary SNOW. Yes, I will submit to you our assessment of the levels of cooperation and the obstacles we are running into.

Senator SHELBY. Obviously, you are trying to marshal the assets, right?

Secretary SNOW. Exactly.

Senator SHELBY. So what role are you playing from Treasury in trying to stabilize the economy there and assist in the rebuilding of the country? And I will start with the monetary system.

Secretary SNOW. Right. Mr. Chairman, there is a far-reaching effort underway involving the Treasury Department. We have a team of people over there right now, headed up by Peter McPherson, a former Deputy Secretary of Treasury and a former head of USAID.

Senator SHELBY. A very able man.

Secretary SNOW. A very able fellow, took a leave of absence from Michigan State University where he is the president. He has assembled a good team of people from the Treasury Department. We have also asked the IMF for assistance on these monetary and financial issues, and the World Bank to do assessments of needs as well.

I think the first task is to get a banking system up and going, a payment system. Mr. McPherson is in regular contact with us on those efforts: a payment system, a banking system, and a sound currency.

Senator SHELBY. How is your \$20 bill program working?

NEW \$20 BILL

Secretary SNOW. That \$20 bill program I think is going to be a great success. It is going to make counterfeiting a lot harder. I was pleased to be able to unveil that \$20 bill here with Chairman Greenspan a week or so ago. It got a lot of attention. It is really going to be an advance in our currency.

Senator SHELBY. Are the merchants there accepting it with open arms in the souks and so forth? That is important.

U.S. CURRENCY CIRCULATION IN IRAQ

Secretary SNOW. It is. Mr. Chairman, the U.S. dollar is playing quite a role in the Iraqi world now. The Saddam dinar, which we hope can be eliminated soon——

Senator SHELBY. Why has it not been eliminated?

Secretary SNOW. Well, because there isn't an alternative currency yet, but I hope it can be eliminated soon. Mr. McPherson and his team, with local Iraqi finance advisers, are looking at that question. Ultimately the currency really ought to be determined by the Iraqi people. But it would be our view that the sooner they can end the Saddam dinar, the better.

There are also so-called Swiss dinars in circulation that come from the north.

Senator SHELBY. How does that work? Are they denominated or tied to the Swiss franc or what?

Secretary SNOW. No. They took the name because apparently the person who got the contract was Swiss, although it was a British company.

Senator SHELBY. That prints the money?

Secretary SNOW. That prints the money. An English company got the contract to print the money, but the person who negotiated it was a Swiss, so they called it a Swiss dinar, apparently.

We have the Swiss dinars in circulation, and we have the Saddam dinars, which have depreciated enormously. Their official exchange rate, if you are a member of the Saddam family, was something like 5 or 6 or 7 or 8 to the dollar. Their current market exchange rate is 3,000 to the dollar.

Senator SHELBY. But the fact that they are even still circulating or have some value is interesting, isn't it?

Secretary SNOW. Well, as I said, I am not happy about that. I think the sooner the new currency is put in place, the better. In the interim, the U.S. dollar is playing an important role. It is found in lots of shops and is being used quite readily.

ESTABLISHMENT OF A CENTRAL BANK IN IRAQ

Senator SHELBY. Are you going to be involved, directly or indirectly, as the Treasury Secretary in recommending the formation of a central bank, an independent central bank for Iraq?

Secretary SNOW. Yes, we will.

Senator SHELBY. That will be independent of the political arena?

Secretary SNOW. Yes, yes. In fact, Mr. McPherson and his team, working with John Taylor, the Under Secretary for International Affairs, and others in Washington, are giving close attention to the question of what the new central bank should look like, what a private set of banking institutions would look like, what the national accounts should look like, what the budget should look like, and what the currency should look like.

But, ultimately, Mr. Chairman, I think those decisions need to be made by the Iraqi people. In the interim, we can get these institutions set up and going and, hopefully, create a good, strong financial foundation for the country going forward.

Senator SHELBY. Would the strong, financial foundation obviously be predicated on the underlying assets of the country such as the oil?

Secretary SNOW. Yes, it would. I think the management of the oil operations of Iraq is absolutely critical to their long-term economic well-being.

Senator SHELBY. Mr. Secretary, I know it will take investment and modernization of the oil fields, which are vast, huge there, but some people have been talking about how Iraq could pump 5 or 6 million barrels a day of oil—maybe not yet, but down the road, after a lot of investment, of course.

Secretary SNOW. Right. Exactly. Well, next to Saudi Arabia—

Senator SHELBY. Second largest oil reserves in the world.

Secretary SNOW. Second largest oil reserves in the world, with huge potential.

Senator SHELBY. And a relatively small population.

Secretary SNOW. Yes. It is a wealthy country if its resources are managed well.

Senator SHELBY. And allocated.

Secretary SNOW. And allocated properly.

Senator SHELBY. Senator Murray.

ECONOMY

Senator MURRAY. I don't have any other questions at this time. I just want to say I was—I don't know if I share your rosy scenario on the economy. My State is really reeling. We have lost 70,000 jobs in the last 2 years. Our unemployment is at over 7 percent. Our State legislature has a \$2.7 billion deficit they don't know how they are going to deal with, and one out of nine Washingtonians don't have health care today. And I am not sure this tax cut is going to help too many of the people I represent. So I would love to say you are right on the rosy economy scenario that you presented to us, but I tell you, I hope this Administration is looking west because we are really struggling.

Secretary SNOW. Well, Senator, I don't want to sound too rosy. I recognize that with our unemployment rate rising, with so many fewer people working today, we have some serious economic problems to deal with. But I do think the foundations have been put in place, with low interest rates, no inflation, high productivity, and lower costs of production for a pretty good recovery once demand comes back. I would dearly love to see those growth numbers get up to those higher levels that I talked about so that your unemployment rate can come down and the unemployment rate nationally can come down. The clear fact is we are way underperforming the potential of this economy. The consequence of that is lots of people's lives are adversely affected; lots of people who would have work don't have work.

Senator MURRAY. I just hope you pay attention to the West because we are hurting.

Secretary SNOW. Thank you. I will do that. Thank you.

Senator SHELBY. Senator Byrd.

BYRD AMENDMENT

Senator BYRD. Thank you, Mr. Chairman. And thank you for being so patient and fair. And thank you, Mr. Secretary and Ms. Ressel.

Well, Mr. Secretary, you know my concerns about what is happening in the steel industry. American steel companies have been devastated by wave after wave of unfairly subsidized and below-cost foreign steel imports. Just yesterday, I believe it was, these waves claimed another victim as Weirton Steel filed Chapter 11 bankruptcy protection.

I hope, as everyone does in the northern panhandle of West Virginia, that Weirton emerges from bankruptcy in a stronger, more competitive position. But two of the programs that the company may rely on to get back on its feet—namely, the emergency steel loan guarantee program and the Continued Dumping and Subsidy Offset Act—have been targeted for elimination by the Administration.

The Administration has sought to eliminate the steel loan guarantee program, rescinding \$97 million in available fund from fiscal year 2003 and requesting zero dollars for fiscal year 2004.

Moreover, the Continued Dumping and Subsidy Offset Act, which I created in 2000, was found to be in non-compliance with World Trade Organization rules. That ruling by a WTO panel is short-sighted, wrongheaded, and dumb. When it ruled against the Byrd amendment, the WTO challenged the right of the United States Congress to distribute Government funds as the Congress sees fit.

National unemployment figures for April showed manufacturing jobs continuing to decline. Factory payrolls have fallen for 33 consecutive months. Listen to that. Factory payrolls have fallen for 33 consecutive months. Over 3 years. Many of those industrial jobs have disappeared forever. We need to take steps now to protect those jobs that we have left and to encourage new growth in manufacturing, and steel jobs are at the core of this effort.

Now, you know my concerns, as I said. When we met in January, we talked about the steel industry and how it was important to so many other sectors of this economy. This Administration continues to advocate policies that would pull the rug from underneath the steel industry as it works to restructure again and to regain its market share. It wants to eliminate the emergency steel loan guarantee program, which I created. Actually, it is giving me a bad cramp in my leg right now. It got me out of bed this morning, that cramp in my leg. I wouldn't be a very good swimmer.

But it wants to eliminate the emergency steel loan guarantee program. It wants to repeal the Byrd amendment and exempt product after product from the Section 201 tariffs. It seems that the only thing that American industrial workers can count on receiving under this Administration is a pink slip.

Now, here is my question. With regard to the Byrd amendment, last February the President recommended the repeal of the continued dumping and subsidy offset—that is the Byrd amendment—in his fiscal year 2004 budget request. This is the law with overwhelming bipartisan support—overwhelming bipartisan support that allows import duties to be distributed to U.S. producers who

are injured by unfair trade to help them invest in their companies and workers.

On May 6th, the U.S. Trade Representative said in its statement on the Byrd amendment before a WTO arbitrator, "Unlike other elements of the budget, the repeal of the Byrd amendment is not tied to the end of the fiscal year and, in particular, it is not intended to be included in the appropriations act." This recent statement by the U.S. Trade Representative is flatly inconsistent with the President's budget request of February 3.

Now, contrary to its earlier proposal, the Administration has made a 180-degree turn and declared that the repeal of the Byrd amendment was never intended to be included in an appropriations bill.

If the Administration's position is that the Byrd amendment should not be repealed, why has the Administration not submitted a budget amendment to the Congress that reverses its earlier recommendation?

Secretary SNOW. Senator, I do not know.

Senator BYRD. That is an honest answer.

Secretary SNOW. Yes. But I will seek to get an answer to that question for you, quickly.

Senator BYRD. Well, it is my understanding that the Inspector General of the Department of Homeland Security is completing a report which will show that the U.S. Customs Service has failed to collect approximately \$90 million under the Byrd amendment. U.S. law requires the Federal Government to collect those duties, and yet, reportedly, it has failed to collect \$90 million.

Up until a short time ago, that responsibility was part of your Department. Why has the Customs Service been unable to comply with these laws enacted to provide legitimate remedies against unfair trade? Why didn't the Treasury Department pursue those lost revenues?

Secretary SNOW. Senator, I am not really familiar with this whole issue. I understand that the study is being completed. Treasury has lost that enforcement responsibility under the transfers to the Department of Homeland Security. I am not on top of that issue in a way to be able to give you an informed answer.

Senator BYRD. Well, the Treasury Department retains control of many of the key provisions of the Tariff Act of 1930, of which my amendment is a part. With all respect, you are the Administration's point man on economic and fiscal policy. Everyone else has been shown the door. The erosion of the Nation's manufacturing sector, including steel, is one of the key elements of our economic weakness. Playing a bureaucratic shell game is simply unacceptable.

As the Administration's voice on economic policy, would you tell the committee whether the Administration believes that it is important to provide support to our manufacturing businesses through this key initiative?

Secretary SNOW. Senator, as you know, I have had a long involvement with steel and served on the board of one of these companies, who very much supported your efforts on behalf of steel, applauded you for doing so. Given that service, I am told that I need to recuse myself from direct answers to questions like that. But

Ms. Ressel will respond for us. Teresa? She didn't know that was coming.

Ms. RESSEL. I need to apologize. I was working hard on making sure that we were correct on the last answer, so I need you to repeat the question. I apologize.

Secretary SNOW. Do we support manufacturing in steel?

Ms. RESSEL. We have to get back to you. I am sorry. I don't know.

Senator SHELBY. Mr. Secretary, could you do that for the record?

Secretary SNOW. Yes, we will.

Ms. RESSEL. We do have an answer to your previous question, sir, about the uncollected antidumping—the \$90 million question. Basically, the original people who were supposed to do that audit were the Treasury IG, and now that responsibility has been transitioned to the Homeland Security IG.

It is our understanding that, for example, in 2002, \$48 million of one particular case is under protest. Basically what we have got is a reconciliation system set up where Treasury's Inspector General will turn that information over to Clark Kent Ervin, who is the Acting IG for Homeland. He is doing a complete reconciliation. We can have those numbers ready for you within a very short period of time. They are closing that out.

I don't know that you will ultimately get a complete reconciliation this year because Customs is saying that they are not going to continue to do collection until all of the open issues have been cleared relative to the protests that the actual importers are eligible to do. That is our understanding of that one. If you want a briefing or any additional information, we would be happy to provide that, sir.

Senator BYRD. Very well. Mr. Secretary, the subcommittee will welcome further responses on this matter, and as you have indicated, you will have something further to report to the committee.

Thank you.

Secretary SNOW. Yes, we will, Senator.

Senator BYRD. Thank you, Mr. Chairman.

Senator SHELBY. Thank you, Senator Byrd.

ADDITIONAL COMMITTEE QUESTIONS

Mr. Secretary, I have a number of questions that I would like to submit to you for the record dealing with your office, the Secretary of the Treasury, and we would appreciate that they be in promptly.

Secretary SNOW. We would be happy to respond, Mr. Chairman.

Senator SHELBY. Senator Murray, do you have any other questions?

Senator MURRAY. No, Mr. Chairman. Thank you.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD C. SHELBY

DEPARTMENTAL OFFICES

Question. The Inspector General and Tax Administration has traditionally been a watchdog over the IRS—an agency in need of constant oversight. The budget proposes to consolidate this office with the Office of Inspector General (OIG) at the De-

partment of Treasury. What benefits will be derived from the proposed consolidation and what will the impact be if the consolidation does not happen?

Answer. The benefit derived by consolidating the Office of the Inspector General (OIG) and the Inspector General for Tax Administration (TIGTA) would be a reduction in overall cost of Inspector General operations. In the post Homeland Security divestiture environment, Treasury incurs duplicative overhead by maintaining both offices which are being paid by the taxpayers with little added benefit. Thus the impact of not consolidating the offices would be the inefficient use of taxpayer money.

The OIG was established in 1988 and TIGTA was created 10 years later to provide dedicated independent oversight to the Internal Revenue Service and related entities. Both offices have the following responsibilities:

- Conduct and supervise audits and investigations.
- Provide leadership and coordination.
- Promote economy, efficiency, and effectiveness in programs and operations.
- Prevent and detect fraud and abuse in programs and operations.
- Provide a means for keeping the Secretary and the Congress fully and currently informed about problems and operations.

Last year, upon the creation of the Department of Homeland Security (DHS) a significant amount of the OIG's responsibilities and budget was transferred to DHS and the Department of Justice (DoJ). This coincided with the transfer of the U.S. Secret Service, the U.S. Customs Service, and the Federal Law Enforcement Training Center's move to DHS and most of the bureau of Alcohol, Tobacco and Firearms' move to DoJ.

Since a substantial portion of OIG was transferred to DHS and DoJ respectively, it makes good business sense to consolidate the balance of the Office of the Inspector General with the Office of the Inspector General for Tax Administration, eliminating duplication by creating a more efficient and effective operation in accordance with the mission of both offices.

Question. The fiscal year 2003 Treasury bill established a fund for a Treasury-wide Financial Statement Audits Program. Why are these funds requested in the Departmental Offices' budget rather than the Inspector General's budget?

Answer. The funds are in the Departmental Offices budget because the Inspector General looks to the Department or its bureaus to pay for financial statement audits performed by contractors. That is, the audit costs should be by the entity being audited (i.e., the Department and its bureaus), not by the Inspector General. The Inspector General only funds the audit work it actually performs; much of the audit work is performed by contractors.

Prior to fiscal year 2003, audit funding for the appropriated Treasury bureaus was decentralized and funding needs varied from year to year depending on who was conducting the audit (i.e., IG, GAO, or a private firm). This resulted in contracting delays and a fragmented approach to the overall financial statement audit. For fiscal year 2003, Treasury obtained the centralized funding, which has greatly alleviated the funding and contracting problems experienced in previous years.

Centralizing the funding and procurement responsibility for these audits has streamlined the process, consolidated the audit work with fewer contractors, enabled greater audit efficiencies, and enhanced the timeliness and consistency of awarding financial statement audit contracts throughout the Department. Further, it has eliminated audit funding uncertainties we previously experienced from year-to-year caused by the mid-year shifting of audit funding responsibilities from the General Accounting Office to the Department and from the Office of Inspector General to the Department's bureaus. These enhancements also help the Department to maintain its leadership role in accelerated financial and performance reporting.

Question. The Office of Foreign Assets Control is the Department's lead agency for identifying terrorist financing and denying terrorist groups access to financial markets. What efforts have been made to garner the commitment of other nations to participate in this effort?

Answer. Since September 11, 2001, the Office of Foreign Assets Control (OFAC) has worked with other nations and the United Nations to garner their commitment to participate in efforts to identify terrorist financing and deny terrorist groups and their support networks access to financial markets and from having dealings with persons in U.N. member states. Over the last 2 years, OFAC has led or participated in more than 20 trips, held bi-lateral meetings with delegations from a dozen countries and representatives from the United Nations and has responded to more than 100 requests for terrorist financing information from more than 50 countries.

OFAC's effort to garner international support to combat terrorist financing has:

- Encouraged several countries, particularly in the Middle East region, to adopt new measures and/or strengthen existing legislation to increase regulatory over-

- sight over charities, other charitable fundraisers and domestic financial institutions in order to prevent their exploitation by terrorist fundraisers.
- Laid the groundwork in several countries for the creation of an OFAC-like administrative sanctions implementing agency and the adoption of new legal authorities to implement administrative freeze and blocking orders pursuant to U.N. obligations.
- Increased compliance efforts by international banking authorities and assisted more than 50 nations with implementing and maintaining asset freeze orders pursuant to U.N. obligations.
- Negotiated international procedures and guidelines which have been adopted by the G-7 working group on terrorist financing and the U.N. 1267 Committee.
- Provided investigative and analytic assistance to countries in Europe and the Middle East to pursue known supporters of terrorism and to exploit new leads to identify and isolate terrorist financiers and financial networks.
- Worked with countries in Europe, Southeast Asia and the Middle East, including Saudi Arabia, to jointly designate terrorists and their support networks.

FINCEN

Question. The USA PATRIOT Act requires FinCEN to implement a number of regulatory requirements.

What is the current status of the implementation of these various provisions?

Answer. Because the Patriot Act not only requires the issuance of rules, but also provides new tools for combating new threats as they arise, and establishes ongoing processes for sharing information, there is no one terminal point for Patriot activities—rather, full utilization of the Patriot Act is an ongoing process (i.e., Sections 311, 314, 361). In terms of reports, FinCEN has issued all the required reports to date; there are reports due in the future relating to whether there are gaps that need to be filled (i.e., Section 324). In terms of rules, FinCEN has to complete the issuance of anti-money laundering program rules, and the final correspondent banking rules.

Question. One of the crucial concepts behind many of these requirements is that the right people see the right information at the right time to prevent terrorists from attacking us again. What steps are you taking to ensure that this is indeed happening and that this vigilance is sustained over the long haul?

Answer. FinCEN is very actively following trends and patterns in the movement of illicit funds and publishes advisories and reports to alert law enforcement and the financial and regulatory communities. In addition to the requests FinCEN receives from law enforcement for assistance in researching and analyzing data to support investigations, it is providing law enforcement with proactive cases. FinCEN also established a new program under Section 314 of the USA PATRIOT Act that allows law enforcement to query financial institutions, through FinCEN, regarding subjects of money laundering or terrorist financing investigations. This program is providing law enforcement with timely and valuable information about investigative subjects, as well as providing opportunities for coordinating investigations. Lastly, FinCEN's Office of Intelligence Liaison (OIL) was established in late 1999, with the goal to identify, through BSA data, clues or leads for law enforcement on possible terrorist-related finances and activities. The analytical products of this office, since its establishment, have contributed to numerous intelligence and law enforcement efforts both proactively and in support of investigations already in progress.

INTERNAL REVENUE SERVICE

Question. The Earned Income Tax Compliance effort has experienced some problems since its inception. What is your suggestion on how to solve this perennial problem?

Answer. Although the Earned Income Tax Credit (EITC) has been successful in lifting millions of low-income taxpayers and their children out of poverty, the EITC program has experienced persistent noncompliance. The IRS attempts to balance enforcement activities with education and outreach programs so that only those taxpayers entitled to the EITC receive it.

The President's Fiscal Year 2004 Budget requested an additional \$100 million to begin a new strategy for improving the EITC program. The IRS will address potential erroneous claims by identifying cases that have the highest likelihood of error before they are accepted for processing and before any EITC benefits are paid. A key part of this strategy is to begin certifying taxpayers in advance for the EITC.

The IRS recently announced additional details and refinements of this initiative. The initiative will specifically:

- reduce the backlog of pending EITC examinations to ensure that eligible taxpayers whose returns are being examined receive their refunds quickly,
- minimize burden and enhance the quality of communications with taxpayers by improving the existing audit process,
- encourage eligible taxpayers to claim the EITC by increasing outreach efforts and making the requirements for claiming the credit easier to understand,
- ensure fairness by refocusing compliance efforts on taxpayers who claimed the credit but were ineligible because their income was too high, and
- pilot a certification effort to substantiate qualifying child residency eligibility for claimants whose returns are associated with a high risk for error.

Below is a press release from the Commissioner:

Taxpayers to Receive Advance Child Tax Credit This Summer

IR-2003-68, May 28, 2003

(Revised June 30 to change mailing dates for notices to check recipients)

Related Fact Sheet: FS-2003-13

Washington.—Beginning the last week of July, eligible taxpayers who claimed the Child Tax Credit on their 2002 tax returns will automatically receive an advance payment of the 2003 increase in this credit, the Treasury Department and Internal Revenue Service announced today.

Taxpayers will not have to take any action to get this advance payment of up to \$400 per qualifying child. The Treasury Department and IRS will perform all the calculations and automatically mail a notice and a check to each eligible taxpayer.

“The only thing the taxpayer needs to do is cash the check,” said Mark W. Everson, IRS Commissioner. “If you qualify, we will send you a notice. There’s no need to call, no need to apply, no need to fill out another form. The IRS will do all the work. A few days after the notice, you will get the check.”

The checks—an advance payment of the 2003 increase in the Child Tax Credit—will be based on the child tax credit claimed on the taxpayer’s 2002 tax return. The Jobs and Growth Tax Relief Reconciliation Act of 2003 increased the maximum child tax credit for 2003 to \$1,000 per child, up from \$600 for tax year 2002. The law further instructed the Treasury Department to provide the difference—up to \$400 per child—as an advance payment to each eligible taxpayer this summer.

The Treasury Department will issue about 25 million of these checks this year, beginning with three principal mailings on July 25, Aug. 1 and Aug. 8. Taxpayers who filed returns after April 15—for example, those with automatic extensions—will receive their advance payments after the IRS processes their returns. They should not make any change to their 2002 returns or remittances based on an expectation of an advance payment check.

The IRS will send notices to taxpayers on July 22, July 29 and Aug. 5, informing them of their advance payment amount. The IRS urges taxpayers to hold on to these notices for their 2003 tax returns. They will need to take the advance payment into account when determining the amount of their child tax credit on the 2003 tax return.

Taxpayers who are not eligible for the advance payment may still qualify for the increased child tax credit of up to \$1,000 when they file the 2003 tax return next year. For instance, a taxpayer who did not have a child in 2002, but had one in 2003, would not receive an advance payment but may qualify for the full \$1,000 credit on the 2003 tax return.

More information is available in answers to frequently asked questions on the IRS website at www.irs.gov.

Question. The IRS is planning to use private debt collectors to collect billions of dollars owed in taxes. What steps will the IRS take to oversee private collectors as well as safeguard taxpayers’ privacy?

Answer. The IRS would establish an oversight group with responsibility for managing case referrals, monitoring and evaluating PCA performance, monitoring interactions with taxpayers, and reviewing and approving PCA invoices. The oversight group would be required to monitor a statistically valid number of taxpayer contacts by each PCA to evaluate taxpayer treatment and adherence to IRS approved procedures. A manual review of PCA activity on taxpayer accounts would be performed to ensure compliance with approved IRS procedures and overall quality of case handling. A full on-site audit of each PCA by the IRS oversight group would be performed on a regular basis and would be in addition to ongoing quality-control and taxpayer protection monitoring.

The PCA would be responsible for ensuring that each employee who has access to taxpayer account information has completed the appropriate background investigation and non-disclosure forms. The PCA would be required to submit verification

of the required background investigation and copies of the non-disclosure forms to the IRS at least 20 days before the employee is permitted to access taxpayer information. In addition, the IRS would adopt tracking procedures developed during the 1996–1997 pilot program to ensure that no PCA employee would be granted access to the IRS work site or taxpayer data until he/she successfully completed a satisfactory background determination. These procedures were very successful during the pilot. The IRS' oversight of PCAs would be similar in many respects to the IRS' oversight of its own employees. For example, the IRS audit system logs for indications of improper accesses to taxpayer information. The IRS also performs oversight of employee work for quality and appropriateness of taxpayer interactions.

PCAs would be required to provide a large amount of information to the IRS, as well as access to various systems, to facilitate IRS oversight. This would include:

- detailed Operational Management Information Systems (MIS) reports,
- telephone Service Level reports,
- audits of employee access to IRS taxpayer data,
- access to PCA collection system for auditing purposes,
- remote telephone monitoring access to authorized IRS personnel,
- PCA employee tracking information,
- PCA employee quality review monitoring evaluations,
- PCA Operational Plans, and
- PCA Business Continuation Plans.

To make certain the IRS promptly hears, evaluates and addresses taxpayer complaints, a PCA would be required to provide to taxpayers, orally and in writing, information on how to report a complaint with the IRS. Any complaint received by the IRS from a taxpayer would immediately be provided to the PCA. If a PCA were to receive a complaint directly from the taxpayer, the PCA would be required to immediately forward the complaint to the IRS.

Upon receipt of a complaint from the IRS or directly from a taxpayer, a PCA would be required to immediately cease collection activity on the account in question and provide to the IRS, by the close of business on the following business day, a copy of its records on the account and any other information relevant to the complaint. The PCA would not be permitted to resume collection activity on the account until IRS resolved the problem and provided the PCA written authorization to resume work. Failure by the PCA to cease collection activity on the account would result in IRS recalling the account from the PCA and, if appropriate, the termination of the PCA's contract.

A PCA also would be required to investigate the complaint and provide a complete report to the IRS within 10 business days of receiving the complaint. The report would include a description of all actions taken to resolve the situation and steps put in place to ensure there are no future occurrences of similar situations.

If a complaint is validated, the PCA would be required to remove the offending employee from the IRS account and take all necessary steps to ensure the employee no longer has any access to taxpayer information. In addition, the PCA's bonus and inventory would be reduced, and the PCA would be subject to a penalty. The IRS could choose to suspend all contract activity for the PCA either permanently or until the IRS has determined, at its discretion, that the PCA had taken appropriate corrective actions to prevent further complaints.¹ The IRS' determination that a complaint was valid would not be subject to review.

If a potential statutory violation is identified, the IRS also would notify the Treasury Inspector General for Tax Administration (TIGTA). TIGTA may investigate the complaint, depending on the circumstances and seriousness of the complaint. If TIGTA initiates a formal investigation of the complaint, the PCA would be required to cooperate fully with the investigation and coordinate its own management efforts with the IRS and TIGTA. TIGTA would provide a report of its investigation to the IRS Contracting Officer after concluding the investigation.

Question. A Treasury Inspector General for Tax Administration report states that IRS deposited some tax refunds into unauthorized bank accounts.

Explain how this mistake could have happened.

Answer. Several factors contributed to the control weaknesses we identified.

—*Instructions for completing the United States Individual Income Tax Return (Form 1040) do not require taxpayers to take any preventive steps.*—Specifically, the instructions do not require taxpayers to void the direct deposit fields if they do not use the fields (e.g., lining through the direct deposit fields on the tax return rather than leaving them blank) to ensure the fields cannot be manipulated subsequent to the filing of the tax return. Furthermore, IRS reports indi-

¹ In determining whether to suspend a contract, the IRS would consider the severity and frequency of valid complaints for a PCA (whether related to one or more employees).

cate that approximately 48 percent of paper filed tax returns are prepared on a computer using tax preparation software packages. When these tax returns are printed, the direct deposit fields are left blank for those taxpayers who elect to receive a paper check tax refund. As with the hand-written paper Forms 1040, the direct deposit fields on these tax returns can be altered.

—*Tax return processing controls are inadequate.*—There are no controls in place to minimize the risk of, or identify potential instances of, employee impropriety via direct deposit in the areas that receive and open tax returns, review the tax returns for completeness, and input the information from tax returns into IRS computers.

—*Procedures do not provide IRS employees with sufficient guidance.*—Procedures were not developed and distributed to those employees who work in the areas that receive and open tax returns, review the tax returns for completeness, and input the information from tax returns into IRS computers informing them of the need to identify and refer cases with potentially unauthorized direct deposits to the TIGTA Office of Investigations.

—*When working refund inquiries, IRS employees did not consider the possibility of this type of employee impropriety.*—Employees in those functions that assist taxpayers who do not receive their refunds were not required to consider the possibility of employee impropriety when evaluating tax refund inquiries that involve direct deposits.

Question. How many checks were deposited into these unauthorized accounts?

Answer. TIGTA has identified one case to date whereby an employee altered paper filed tax returns to divert, via direct deposit to personal bank accounts, approximately \$32,600 in tax refunds from multiple taxpayers for 2 tax years. The tax refunds stolen ranged from \$2,252 to \$8,133.

This employee worked at a Submission Processing Site. From on or about February 28, 2000, to and including April 28, 2000, and again from on or about February 20, 2001, to and including April 30, 2001, this employee altered tax returns to include direct deposit account information that was not requested or authorized by the taxpayers. The purpose of the alterations was to divert the taxpayers' refunds to bank accounts belonging to and controlled by the employee.

The employee was successfully prosecuted.

Question. What steps has the IRS taken to make sure this does not happen again?

Answer. TIGTA alerted IRS executives on June 25, 2002, to the control weaknesses in the processing of paper filed tax returns that provide opportunities for tax refunds claimed on paper filed tax returns to be directly deposited to bank accounts that were not authorized by the taxpayers. As a result of this alert, IRS management added this risk as a reportable condition to the tax processing Annual Assurance Process memorandum. In addition, IRS management implemented a number of corrective actions including developing and issuing guidance in response to audit recommendations made during the course of our review.

IRS management agreed with the recommendations presented in our report and is planning to take corrective action. Specifically, the 2003 instructions for completing Form 1040 will be changed to tell taxpayers to line through the direct deposit fields on the tax return if they are not requesting a direct deposit of a refund check. In addition, Submission Processing procedures will be changed to instruct Code and Edit function employees to line through this section if a taxpayer fails to follow the instructions. Also, the IRS will contact the software developers and request that they modify their programs so that the fields do not appear or cannot be altered if a taxpayer wishes to receive a paper refund check. These changes will be effective for Tax Year 2003.

Question. The IRS has an obligation under Title 31 (i.e., compliance and enforcement of non-bank financial institutions). Is the IRS adequately funded for its Title 31 functions and operations and the critical support that the Detroit Computing Center provides to FinCEN?

Answer. The Small Business/Self-Employed (SB/SE) operating division of IRS is responsible for the non-bank financial institution (NBFI) compliance examinations for Title 31. In fiscal year 2003, SB/SE expanded the Anti-Money Laundering (AML) program to include over 30 AML groups across the country. Significant training resources were expended to ensure that the newly reassigned Revenue Agents (RAs) were properly trained to conduct the Title 31 compliance examinations and to refer potential criminal cases to IRS-Criminal Investigation, if warranted. IRS efforts to incorporate increased compliance responsibility due to the numerous regulations prompted by the USA Patriot Act more than doubled the number of NBFI compliance examinations conducted during fiscal year 2003. However, the Achieving Balanced Levels of Enforcement (ABLE) initiative under the Fiscal Year 2004 Budget Submission, if funded, would allow IRS to increase Title 31 compliance examination

coverage and enforcement responsibilities. This initiative would provide additional Revenue Agents to implement selected provisions, i.e., section 352, of the USA PATRIOT Act and to expand overall Title 31 compliance examination coverage given the increasing focus on money laundering within the related non-bank financial institutions.

The Business Systems Development (BSD) staff at the Detroit Computing Center (DCC) performs programming and maintenance for the Currency and Banking Retrieval System (CBRS). CBRS is a large database, encompassing all Bank Secrecy Act (BSA) forms, the CBRS query system, sub-systems, and various other entities. There is an overall need to retool the CBRS to provide flexibility to meet the increasing complex research and data analysis needs of law enforcement. Treasury, FinCEN, and IRS are in discussion on the best approaches to this modernization. Regardless of the future retooling, IRS must keep pace with the new regulations issued under the USA PATRIOT Act. Form revisions and new forms required by the USA PATRIOT Act must be added to the current database for immediate use. These changes may require changes to the magnetic or electronic systems or building new systems to handle the additional volume.

SUBCOMMITTEE RECESS

Senator SHELBY. Mr. Secretary, we appreciate your appearance here today. We know you are busy, and we appreciate your candor with the committee and look forward to working with you in the future.

Secretary SNOW. Thank you very much.

Senator SHELBY. Our meeting is in recess.

[Whereupon, at 12:23 p.m., Tuesday, May 20, the subcommittee was recessed, to reconvene subject to the call of the Chair.]